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MASTERING THE WORLD ECONOMY

HEARINGS

BEFORE THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

ONE HUNDREDTH CONGRESS

FIRST SESSION

FEBRUARY 19, 1987

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MASTERING THE WORLD ECONOMY

THURSDAY, FEBRUARY 19, 1987

U.S. SENATE,
COMMITTEE ON FINANCE,
Washington, DC.

The committee met, pursuant to notice, at 9:30 a.m., in room SD 215, Dirksen Senate Office Building, the Honorable Lloyd Bentsen (chairman) presiding.

Present: Senators Bentsen, Matsunaga, Baucus, Bradley, Mitchell, Riegle, Rockefeller, Daschle, Packwood, Roth, Danforth, Chafee, Heinz, Wallop, Durenberger, and Armstrong.

[The committee press release and the prepared statements of Senators Bentsen, Dole, Baucus and Heinz follow:]

[Press Release, February 9, 1987]

FINANCE COMMITTEE CHAIRMAN BENTSEN ANNOUNCES CHANGE IN TIME FOR FEBRUARY 19, 25, AND 26 TRADE HEARINGS

WASHINGTON, DC.—Senator Lloyd Bentsen (D., Texas), Chairman, announced Monday that the trade hearings originally scheduled to begin at 9:30 a.m. on Thursday, February 19 (final in the series, "Mastering the World Economy"), and Wednesday and Thursday, February 25 and 26 (Management of the U.S. Customs Service), will now begin at 10:00 a.m., on the same dates, rather than the previously announced times.

STATEMENT OF HON. LLOYD M. BENTSEN ON MASTERING THE WORLD ECONOMY

This is the last of seven hearings we have held in this Committee since January 13 of this year entitled "Mastering the World Economy." We have heard from leaders of the business community, labor leaders, and recognized experts. These people have been kind enough to avoid speaking to specific legislative proposals at this stage for the most part. Instead, they have addressed two basic questions, which we must answer with a common voice in order to actually make a difference on trade. The two questions were,

What should be our international economic objectives as a nation? and

How is our country going to earn its way in the new global economy that is upon us?

As I sat here the first day of our hearings and listened to the statements of the members of this Committee, I wondered, "How are we going to bring all these different points of view together"? And yet two weeks ago 58 members of the Senate, including 17 members of this Committee, joined in introducing S. 490, a bipartisan trade bill that will be the starting point in the Senate for the effort to produce an international economic policy for the United States this year.

Of course, six hearings did not resolve all the differences on trade policy in this Committee. The trade bill we introduced is a starting point, not the end product. But our hearings did produce surprising unanimity on four points:

First, we are faced with a serious but complex problem. Our country is going deeply into debt, and if that debt is not to be a charge upon future generations, then we must take steps now to begin earning our way in the world. The longer we wait to act, the more painful the medicine will be, but it will not be sufficient to legislate on trade; we must also make policy on a broad range of related fields, from currency exchange arrangements to the education of our children. And the whole thing has to work together, as one policy.

Second, we must have a national policy. We must all work together—Democrats and Republicans, House and Senate, Congress and President—if we are to find our way out of debt and dependency. There is consensus that unless Congress is in on international economic policy making—especially trade policymaking—from the beginning, our President cannot be an effective leader of the world economy.

Third, world trade must grow. We cannot tolerate stagnant international trade as we have for the past six years. This means that the American standard of living can improve through trade, but not if America is the world's only major importer. Our businesses have to make a more competitive product, but our trading partners have to open their economies—not only to our exports directly, but to the exports of the developing world where the greatest potential markets lie.

And finally, the United States must lead the world trading system. Leadership today means using our leverage. Retaliation for unfair trade practices has virtually unanimous support, but we also need a stong policy of promoting positive adjustment to imports and active bilateral negotiations. Tough policies are necessary, but it is also necessary that they serve a positive objective—the growth of world trade.

Now there are two groups we have not heard from. The first is the House of Representatives, which is currently also working on a bill. Hopefully, they will send us a bill shortly, so that we can consider their ideas.

The second is the Administration. We are very fortunate to have Secretary Baker and Ambassador Yeutter here today to address our broad subject matter.

Our process here in the Senate has been bipartisan from the start, but we have also gone out of our way to ask the Administration for its ideas. Indeed, I lobbied the President himself about the subject, and he was kind enough to volunteer that he hoped he would be able to send up a bill. As I understand it, an Administration bill will be introduced later today. Once the Administration bill is introduced, then we can consider it.

We will begin with Secretary Baker, and then Ambassador Yeutter will join us about 11:00 am. Mr. Secretary, if you will please proceed any way you wish.

STATEMENT OF HON. BOB DOLE

Mr. Chairman, It's a pleasure to welcome Secretary Baker and Ambassador Yeutter here this morning.

You've had all that practice negotiating with the Japanese, the Germans, the Canadians: Now you're ready for the Hill, and I wish you luck.

I will be introducing the administration's competitiveness proposals this afternoon in the Senate. It is a remarkable document, and not just because it's over 2,000 pages long.

It is, I believe, historic. It represents a national commitment to restore American strength and influence in the international economic community.

Too often we think of American power purely in terms of military force. But that is a hollow shell if our Nation is sapped of its economic vitality.

The program of action which we have before us is reminiscent of the efforts by Presidents Eisenhower and Kennedy, in the aftermath of Sputnik, to return us to our rightful place in the world technological competition.

Now we must return to our rightful place in the world economic competition.

There is much talk of competitiveness up here on the Hill. Senators Baucus and Chafee, for example, have spoken eloquently about it as chairmen of the Senate Competitiveness Caucus. So too have my other colleagues on the committee.

And yet the only competitiveness proposals which have been presented to the Congress are those of the administration which come forward today.

Gentlemen, this is where the action is. And the administration is to be congratulated for it.

Now the ball's in our court. The challenge is before the Congress to act, and act swiftly on this legislation. If we don't, all of our rhetoric is meaningless.

Many of us have, in the spirit of bipartisanship, supported the excellent work of the chairman in drafting recent trade legislation. We have wanted to show that this is not an ideological or partisan matter as much as a practical challenge to solve common problems.

Now I think we should do the same for the administration's competitiveness program. Let it have our bipartisan support. We can change some of its particulars, if we want, but let us demonstrate first that it represents the sort of program that we in the Congress have been calling for.

If we believe what we say about the competitiveness crisis, it may be our last chance.

STATEMENT OF SENATOR MAX BAUCUS

Mr. Chairman, I'm glad to have Secretary Baker and Ambassador Yeutter here today. It gives us a chance to get to what I consider is the heart of this trade issue—Presidential discretion.

Congress feels the President has not used his discretion to protect America's trading interests. Trade isn't high enough on his list of priorities. In a fight between foreign policy and trade, foreign policy wins every time. We in Congress would strike a differrent balance. But the President is ignoring Congress.

That puts us in a tough spot. Congress can set the outlines of trade policy. It can legislate. But we can't do the day to day management of trade policy. We can't decide in every case whether the goodwill of some nation is worth more than the well-being of a U.S. industry. In the end, we must grant the President some discretion to administer the law.

That means the President must see Congress as a partner—not an afterthought—when it comes to making trade policy. The President must show leadership that does not ignore Congress and the rest of the country. After all, this is a country that moves best when we all move together.

If we're honest, we should recognize that the President recently has taken some stronger action or trade. But has his action only been a response to Congressional pressure? Will he continue to take stronger action once the pressure is off?

We don't know. In short, the glue is still missing. Congress still does not sense that the Administration is committed to a trade partnership. But it's that sense of partnership that will be critical in the months and years to come.

In the past, foreign policy has driven economic policy. Economic policy was a tool used to accomplish our foreign policy objectives. That's changing. In a country suffering a $170 billion trade deficit, economic policy must receive more immediate attention. As we move toward the 21st Century, I believe economic policy increasingly will drive foreign policy.

When that happens, the need grows for a partnership between the Administration and Congress. Article One of the Constitution gives Congress primary authority over trade policy. As the importance of trade policy grows, we must cement a stronger partnership between the Administration and Congress. If we do not, our trade policy will continue to be a battleground between our branches of government.

I understand the President will submit his trade proposals today. That's a good start. I applaud the Administration for putting forth its own proposals. That is the beginning of any good partnership.

But the partnership I envision involves more than putting forth proposals. It involves more than consultation with Congress. It involves a genuine willingness to cooperate and compromise over specific provisions. It recognizes that the Constitution grant Congress the lead role in developing trade policy.

I welcome Secretary Baker and Ambassador Yeutter here today. I have enjoyed working with them in the past. I look forward to working with them in the months ahead. And I look forward to discussing trade policy with them today.

STATEMENT OF SENATOR JOHN HEINZ

This hearing is the fifth in the Committee's series on trade policy, and today's witnesses are from the Administration. Their appearance here today is particularly welcome because of what appears to be something of a change in view on their part with respect to the need for trade legislation.

I know the Chairman welcomes the President's willingness to work with the Congress on trade legislation, and I certainly do so as well. In turn, I believe the Committee's willingness to undertake such discussions is also sincere, and I look forward to the happy possibility that all our views will merge into one grand consensus with a minimum of bitter debate.

I suspect, however, that that a naive hope; that our mutual willingness to work together continues to mask very real differences on causes and nature of our trade problems and on their solution. Thus far, however, most of the witnesses before the Committee have analyzed the problem in a similar way and have attributed a good deal of it to our collective failure to understand how the world economy operates. While no one has any illusions that the trade deficit can be corrected overnight or that the removal of barriers alone will restore balance in the short term, there seems to be a growing consensus on the need for a more aggressive trade policy generally because of its long term impact in forcing the trading system to operate on market principles.

The Administraion has in the past expressed some skepticism about this line of reasoning, and I look forward to their testimony today to learn if their new found interest in trade legislation is tactical or substantive.

The CHAIRMAN. This hearing will come to order.

This is the last of seven hearings in which we have dealt in background matters, not with specific legislation but trying to address two overall general questions: What should our international economic objectives be as a nation? And how is this country going to earn its way in the new global economy that is upon us?

This country of ours has been internationalized when it comes to trade, and it is critical as to what our policy decisions will be.

As I listened through these hearings, I wondered how in the world we could resolve the different points of view that were expressed by each of the members of this Committee. Yet, two weeks ago, 58 members of the United States Senate, joined by 17 members of this Committee, joined in introducing S. 490, a bipartisan trade bill that is going to be the starting point in the Senate for the effort to produce an international economic policy for the United States this year.

Of course, all those six hearings didn't resolve all the differences on trade policy; but that trade bill is a starting point, it is not the end product. But our hearings did produce, I think, rather surprising unanimity on four points:

First, that we are obviously facing a very serious and complex problem, that our country is going deeply into debt, and if that debt is not to be a charge upon future generations, then we have to take steps to earn our way in the world. The longer we wait, the more painful that medicine is going to be. But it will not be sufficient just to legislate on trade. The one thing I don't want to do is to oversell a piece of legislation, as though it is going to resolve all of our problems. What it will really do is work at the margins, and I think that will help. The whole thing has to work together as one policy, whether we are talking about currency exchange arrangements or we are talking about the education of our children.

Second, we must have a national policy. We must all work together as Democrats and Republicans, House and Senate, Congress and the President, if we are to find our way out of debt and dependency.

There is a consensus that unless Congress is in on international economic policymaking, especially trade policymaking, from the beginning, our President cannot be an effective leader of the world economy.

Third, world trade must grow. All through the Seventies world trade grew, and the world prospered. In the Eighties, it has flattened out. If it wasn't for the deficit in trade in this country, world trade would be down by some 5 percent.

Finally, the United States must lead the world trading system. Leadership today means using our leverage. Retaliation for unfair trade practices has virtually unanimous support, but we also need a strong policy of promoting positive adjustment to imports and active bilateral negotiations. Tough policies are necessary, but it is also necessary to have a positive objective, and that is the growth of world trade.

Now, we have not heard from two groups. We have not yet, of course, heard from the House of Representatives, which is currently working on a bill, and hopefully they will be sending us a bill shortly so that we can consider their ideas. The second is the Administration. We are very fortunate to have Secretary Baker here to address the subject matter.

Our process here in the Senate has been bipartisan from the start, but we have also gone out of our way to ask the Administration for its ideas. We want them to be a part of the process. Indeed, I lobbied the President myself on the subject, and he was kind enough to volunteer that they would be able to send up a bill. As I understand it, an Administration bill will be introduced within the next few days, if not today. And once the Administration has introduced it, then we will look forward to considering it.

I would like to turn now to the Ranking Minority Member, the distinguished former chairman, Senator Packwood, for any comment he might have.

Senator PACKWOOD. Thank you, Mr. Chairman.

I totally agree with the goal that Senator Bentsen has set forth, but I think the one thing we need to be careful of is that there is a large group in this Congress, which does not include the Chairman of this Committee, that wants to use the trade bill as a smokescreen for straight-out protectionism. This Congress is about one-third protectionist year in, year out, in good times a little more than in bad times, but I mean people who are simply prepared to say we are not going to sell any computers and we are not going to buy any Toyotas, "We are 240 million people. We will put up the barriers. We won't buy or sell overseas except for raw materials in short supply." And that simply won't work. The outcome of that philosophy will be a gradual increase in consumer prices, a gradual decrease in the quality of our products, and eventually the end of America's technological, economic, and trade lead in this world.

So, I think the hearings are a good idea; but I think we should continue on the track we have been on since Cordell Hull, and that is the track of attempting to lower tariff and non-tariff barriers. We've got a big stick to use—our market is a big stick. And I have no objections to the Administration, be it Democrat or Republican, using it in order to gain us access to foreign markets. And it can be used.

But I am reluctant to pass any bill that will make it more difficult for the President to bargain or, on occasion, would compel retaliation when there may be more at state than soley the injured industry.

Thank you, Mr. Chairman.

The CHAIRMAN. Realizing the limitations on time, I would ask that any further opening statements be put in the record.

We will be hearing this morning from the Secretary of the Treasury and, in turn, we will be hearing from Ambassador Yeutter, following him.

Mr. Secretary, we are delighted to have you here.

STATEMENT BY HON. JAMES A. BAKER III, SECRETARY OF THE TREASURY, WASHINGTON, DC

Secretary **Baker**. Thank you very much, Mr. Chairman, and I am delighted to be here. If it is all right with you and the Committee, I would like to summarize my prepared testimony and ask that it be inserted in the record.

Before I outline, Mr. Chairman, the President's program on trade and competitiveness, I would like to offer a word of thanks and a word of respect, if I might, to you and to the members of this Committee. I know and appreciate that it is your intent to fashion a bill that enhances this country's standing as the world's paramount economic power, and not a bill that calls for a protectionist retreat.

In the past we have worked closely together to serve the national interest—often in the face of powerful factions demanding special treatment—and I look forward to taking up that challenge with you, Mr. Chairman, and with this Committee again in this new arena, to ensure that the popular responses of the moment are subject to our reason and subject to our collective judgment.

President Reagan has established a national goal of assuring America's competitive preeminence into the Twenty-first Century. This is an endeavor, Mr. Chairman, that must reach to the core, really, of American society. Our businesses need to rely on their operational prowess and reputation for quality products, instead of government guardianship. Our capital markets have to pay attention to the entrepreneur, the little guy with the big ideas. Workers have to take charge of their futures by making education and training a lifetime endeavor. And government at every level must encourage reform and must encourage excellence.

The President's strategy has six parts, and I would like to describe each very briefly. And, Mr. Chairman, I understand that the legislative language of our package should be forwarded to the Congress sometime during the course of the day today.

First of all, we have to increase our investment in human and intellectual capital. We need schools that prepare our children for a new technological age, while building the values of old-fashioned striving and accomplishment.

Because the need for educational reform extends far beyond the classroom, we are also proposing a worker adjustment program to help an estimated 700,000 newly dislocated workers each year, almost triple the number served under existing programs. We will also advance an $800 million initiative to give needy young people remedial education and training, so that they can have an opportunity to make it on their own.

A second element of the President's strategy is to further America's preeminence in science and in technology. We will establish new interdisciplinary science and technology centers at universities to further basic research, to double the National Science Foundation budget over five years, and we will establish research consortia and exchanges to enhance the development and transfer of knowledge between the private sector and the public sector. We will also be undertaking some major R&D initiatives—a space station, a hypersonic aircraft, global geosciences exploration, DNA mapping, among others—and will direct the National Science

Foundation and the Department of Education to work with state and local governments to develop a new scientific literacy program for our children, similar to the one we launched at the dawn of the space age.

Third, we are taking steps to better protect United States intellectual property, at home and abroad. It is crucial to protect those who create ideas and inventions while giving them an incentive to market their products.

We urge a number of statutory reforms to encourage licensing and to enhance patent and copyright safeguards.

Fourth, we propose reforming outmoded antitrust laws, product liability, export control, and other rules that place this country at a disadvantage in the world marketplace.

The fifth element of the program is to urge continued efforts to control federal spending. The President's budget meets the Gramm-Rudman target for Fiscal 1988, and it is our view that we have to add to the progress—substantial progress, if I may say so—that we expect to achieve in Fiscal 1987. But now that we have turned the corner with respect to the budget deficit, we can't slacken our pace.

The final part of the strategy you spoke to, Mr. Chairman, is to shape an international environment through new American leadership in which our knowledge and our talent and our entrepreneurial abilities can flourish. In the past year we have moved forward in the areas of economic policy cooperation, our debt initiative, and in the pursuit of fair and open markets. We have made progress in establishing the fundamental conditions for balanced global growth and for a reduction in external imbalances. The dollar has now depreciated substantially against the currencies of the other major industrial countries since its February 1985 peak, and two-thirds of that adjustment has occurred since the Plaza Agreement of September 1985.

The industrial countries have sustained moderate growth, and the non-oil-exporting developing countries have turned in a fairly strong growth performance over the last year.

Many observers believe that external imbalances among the major industrial countries may have in fact peaked in 1986. The exchange rate changes have helped bring about a leveling off of the United States trade deficit. We are confident that the cumulative effect of the changes will contribute significantly to a reduction of that trade deficit in 1987.

The challenge now is to achieve further substantial reductions in these external imbalances. Exchange rates do play an important role in the adjustment process, but they cannot and they should not be the sole mechanism.

To hold the costs of adjustment to the minimum, exchange rate changes must be complemented by stronger growth abroad and by measures to adjust the structures of our economies. We expect to continue to impress on other industrial countries, particularly those with large external surpluses, our mutual need for them to achieve stronger sustained growth.

The newly industrialized countries in Asia also have a responsibility for contributing to the adjustment of our external imbalances. Open markets contributed much to the development of these economies. Many NICs are ready to enter the world trading system as full-fledged participants. One essential element will be that they follow policies that allow their currencies to better reflect the economic fundamentals, and they must open their markets, of course, to foreign trade and to foreign direct investment as well.

We all have a stake, Mr. Chairman, in constructively addressing external debt difficulties among developing nations. We are proceeding not through quick-fix gimmicks but through what we think are lasting solutions to some very serious underlying problems.

Our debt strategy focuses on improving the debtors' growth potential, through both macroeconomic and structural reforms, supported by modest new financing, essential to meet the needs of growth. I think considerable progress has been made. Many debtors are already taking important steps to increase savings and investment, improve economic efficiency, privatize public enterprises, and encourage the return of capital flight.

The International Monetary Fund has negotiated new standby programs with eight of the 15 major debtors. The World Bank has negotiated new policy-based loans with 10 major debtors, and the commercial banks are moving to make new loans available, as exemplified by recent packages for Mexico and Nigeria.

Mr. Chairman, I would submit to you that this is a good start. Obviously, we hope for further progress. Renewed economic cooperation in our LDC debt strategy has got to be coupled with a vigorous trade strategy as well—a firm opposition to unfair trade practices, market liberalization through bilateral and multilateral negotiations, and the rejection of protectionism, in all of its guises, as the greatest threat to a competitive America.

Let me mention several measures we have been taking:

As the President noted in his State of the Union address, we are engaged in historic negotiations with our largest trading partner, Canada, on a free trade agreement. We urge private citizens and organizations in the United States to work closely with us, so we can forge an agreement with Canada that best serves our economic interest.

In the new round in the GATT, we are working to ensure that the laws of the world trading system are relevant to the commercial realities of the Twenty-first Century.

We will continue to use our authority aggressively under the "war chest" program to counter foreign predatory financing practices.

We will introduce comprehensive statutory changes to improve our trade laws, including sections 201 and 301 and our antidumping and countervailing duty laws.

We want changes that enhance our abilities to meet the challenges from abroad without erecting protectionist barriers here at home. And I know that Ambassador Yeutter will be here with you today to discuss these trade proposals in detail.

Mr. Chairman, we are ready and willing to work with you and with this committee to improve these laws. For the most part, our trade laws have been effective instruments for opening foreign markets and for defending Americans against unfair trade practices abroad.

Regardless of reforms that are needed, the principle behind these laws, in our view, stands firm, and that is simply this: Competitive markets best serve America.

It is clearly the turn of our exporters to benefit from a greater growth abroad and a more reasonably-valued United States dollar. If they are to have access to markets abroad, however, we must keep our own markets open here at home. As Senator Packwood has said, we could not pick a worse time to unfurl the banner of protectionism.

We urge the Congress to measure our proposals against five key considerations, and those are these:

First, do they facilitate the competitiveness of U.S. industry? Secondly, do they conform to our international obligations? Third, do they enhance our leverage in the Uruguay Round and in other international trade negotiations? Fourth, do they avoid provoking costly retaliation against United States exports? And, fifth, do they avoid spurring our trading partners to enact mirror legislation that would harm United States exports?

Some of the proposals that we have seen run counter to these principles; and, without suggesting an all-inclusive list, I can note that the Administration will resist the following:

First, that we would impose a general import surcharge. This surcharge would spur inflation, it would prompt retaliation by our trading partners, and it would hurt American industries that rely on imports.

Second, we oppose sector-specific protection, such as establishing import quotas for individual products. This route not only has all of the drawbacks of a surcharge but it would also be unfair to industries not receiving favored treatment. The textile quota bill, which the President vetoed, is a case in point.

Third, we oppose mandatory retaliation. Retaliatory proposals can be useful in bringing about a solution, but a rigid, statutory mandated approach that dictates to foreign nations is unlikely to lead them to reduce their barriers. It is far more likely to result in a counterattack against United States exports.

And finally, Mr. Chairman, it comes as no surprise, I know, that we oppose limits on Presidential discretion. If we are to be successful in negotiating more open markets, the President really does need the flexibility to bargain. If our negotiators' hands are tied by statutory mandates to take certain actions in specific situations, they can be easily outmaneuvered; or the negotiating process will break down, producing a protectionist result for everyone.

The foregoing proposals, like some others which have been under consideration, we think are unwise and we think would be counterproductive. They are compatible with a rigid high-cost market environment relying on protectionism. Mr. Chairman, this country has prospered for 200 years because it has been a dynamic, flexible environment that has blended competition and cooperation to forge a very unique economic union. In our view, we would be very mistaken to reject this legacy.

The United States is facing new challenges in a changing world economy. The President's Competitiveness Initiative will help America address these challenges and will help it enter the Twenty-first Century competent and strong.

I know that I and others in the Administration look forward to working with the Congress on this program. Together we can serve the public interest by encouraging the evolution of a vigorous, vibrant, forward-looking society, one that is worthy of our heritage as a great trading nation.

Thank you, sir.

The **CHAIRMAN**. Thank you very much, Mr. Secretary.

[Secretary Baker's written statement follows:]

Testimony of the Honorable James A. Baker, III
Secretary of the Treasury
Before the
Senate Finance Subcommittee on International Trade
February 19, 1987

Mr. Chairman and Members of the Committee:

It is a pleasure to meet with you today to discuss the Administration's proposals for improving the ability of the United States to compete in the world economy. I understand the legislative language of the Administration's competitiveness package should be forwarded to the Congress today.

I know it is the Chairman's intent to fashion a bill that enhances America's standing as the preeminent economic power, not a bill that calls a protectionist retreat. In the past, we have worked closely together to serve the national interest -- often in the face of powerful factions demanding special treatment. I look forward to taking up that challenge with the Chairman and the Committee again in this new arena -- to ensure that the popular responses of the moment are subject to our reason and our judgment.

It is easy to understand the general concern. The trade figures are stark, and the newspaper headlines are grim. This concern -- and the anxiety which it provokes -- can prevent strategic thinking on the problems of international competitiveness and trade. It can lead to quick-fix solutions that aren't really solutions at all -- just reflexive measures with superficial appeal.

What is needed is a program of action that confronts the issue completely and for the long haul. This program of action, presented by the President in his State of the Union message, addresses a key underlying cause of the trade problem -- America's competitiveness. Trade legislation plays a role in this program, but other measures are equally if not more important.

The President's Competitiveness Initiative

Of the many factors that affect the ability of a country to sell its goods and services both at home and abroad, no factor is more important than the competitiveness of its products.

How do we make competitive products? By running our businesses efficiently, by encouraging innovation and setting high standards of quality, and by making sure our workers have the skills they need not only for the tasks at hand but for the tasks to come. Government can either help this process or hurt it.

The President has established a national goal of assuring America's competitive pre-eminence into the 21st century. This is a call for aspirations, for achievement. We -- and you -- must employ our influence to persuade the public that it's time for an American transformation. This is an endeavor that must reach to the core of American society. Our businesses need to rely on their operational prowess and reputation for quality products, not government guardianship. Our capital markets must pay attention to the entrepreneur, to the little guy with big ideas. Workers must take charge of their futures by making education and training a lifetime endeavor. Government, at every level, must encourage reform and excellence.

To fulfill the Federal Government's responsibilities, the

President has launched a six-part program aimed at:

-- Increasing investment in human and intellectual capital;

-- Promoting the development of science and technology;

-- Better protecting intellectual property;

-- Enacting essential legal and regulatory reforms;

-- Reducing the budget deficit; and

-- Shaping the international economic environment.

Each of these six elements will help make America -- and its products -- more competitive, thereby improving the standing of the United States in the world economy.

o Increasing Investment in Human and Intellectual Capital

To achieve competitive preeminence, we must increase our investment in human and intellectual capital. There is no resource more important than our own people.

We must continue the pursuit of excellence in our schools. Steps in this direction include emphasizing the mastery of basic subject matter, science, and computer skills, particularly at the elementary and secondary school level, and establishing a national goal of reducing illiteracy to ensure that every American learns to speak and write English so as to be able to participate fully in our society.

Because the need for educational reform extends beyond the classroom, the President will propose a new $1 billion worker adjustment program that will:

-- Help an estimated 700,000 newly dislocated workers each year (almost triple the number served under existing programs). The program will cover all workers, including farmers, not just those affected by imports;

-- Offer counseling, job search assistance, basic education, and job skill training; and

-- Provide training and adjustment opportunities to workers early -- long before they exhaust unemployment benefits.

To achieve the goal of integrating the disadvantaged of our nation into the mainstream of American life, the President will also propose two interrelated initiatives for recipients of Aid to Families with Dependent Children (AFDC). The first is the AFDC Youth Training program, which will allow states and localities to use $800 million for year-round remedial skill training and education for young people recieving AFDC assistance. The second is a new employment and training program in AFDC called Greater Opportunities Through Work (GROW). GROW will encourage teenage parents and children who have not completed high school to stay in or return to school.

Further, the President will propose statutory amendments to refocus the Employment Service (ES) and to transfer responsibility for financing and administering state unemployment insurance and ES to the states. This will provide states greater flexibility in helping unemployed individuals get back to productive jobs.

By giving our children the education and training they need to become productive members of society, and by helping our workers adjust to the changing job environment, we can ensure the availability of the skill and talent required to fuel a growing, dynamic economy. This is the first element in creating a more competitive America.

- o Promoting the Development of Science and Technology

The second element is promoting the development of science and technology -- the centerpiece of U.S. competitiveness.

The President's initiative in this area focuses on maintaining U.S. pre-eminence in initiating ideas and know-how and in translating these ideas into new products and processes. To this end, the President has identified three national objectives: generating new knowledge in advanced technologies; swiftly transferring new technologies to the marketplace; and expanding the nation's talent base in science and technology.

To achieve these objectives, the President has developed a variety of initiatives, including:

-- establishing a number of new university-based "Science and Technology Centers" that will perform long-term science and engineering research in vanguard fields such as robotics and biotechnology;

-- promoting greater interplay between the public and private sector in the area of research and development (R&D) by improving industry access to the Federal science and technology enterprise and by creating special exchange programs;

-- continuing the Administration's strong budgetary support for basic research; and

-- seeking stability in the R&D tax credit.

All of these measures will contribute to building America's competitive base in a world economy that is increasingly technically oriented.

o Better Protecting Intellectual Property

The third element in the President's competitiveness initiative is better protection for intellectual property. It is vital to ensure adequate protection, both domestically and internationally, to those who create new ideas and invent new products and services.

We can do this by seeking statutory changes that would, for example, permit U.S. adherence to the Berne Convention for the Protection of Literary and Artistic Works, thereby expanding U.S. copyright relations to include 20 additional countries. We also urge a number of other measures to protect U.S. commercial interests, including directing Federal agencies to take into account the level of U.S. intellectual property right protection when negotiating international agreements or providing bilateral economic assistance.

o Enacting Essential Legal and Regulatory Reforms

Outmoded rules and regulations and self-imposed disincentives place us at a disadvantage in the world marketplace. The fourth element in the President's initiative therefore addresses the legal and regulatory reforms needed to eliminate such obstacles to competitiveness.

For example, the President will propose statutory changes so that our antitrust laws reflect the dynamics of world trade. These comprehensive changes are aimed at enhancing the vigor of American businesses, while continuing to protect consumers and firms from monopolies, cartels, and price-fixing. In addition, the President has directed the Cabinet to undertake a review of the export controls program and recommend improvements in the system which will lessen the burden to U.S. business without diminishing U.S. national security.

- Controlling Federal Spending

The fifth element concerns Federal spending. The President has underscored his commitment to controlling Federal spending through introducing a budget that meets the Gramm-Rudman targets for FY 1988, without increasing taxes.

It is imperative that we maintain the deficit reduction momentum that we expect to achieve in FY 1987. I recognize that any venture involving budget cutting will breed differing views -- some strongly held. But now that we've turned the corner, we can't slacken our pace.

- Shaping the International Economic Environment

Of key interest to this Committee and its members is the sixth and final element of the President's Competitiveness Initiative -- shaping the international environment.

Experience of recent years has brought home to all of us here today just how interdependent the world economy has become. The effect on large segments of U.S. industry of deterioriating U.S. trading accounts has been painfully clear in this country. At the same time, our efforts to contain inflation have been aided importantly at various junctures by an appreciating dollar and declining international commodity prices. Nor can we overlook the role that capital inflows from abroad have played in supporting our own economic expansion.

The large U.S. trade deficit reflects the myriad linkages between our economy and the rest of the world. Exchange rate changes, the strong pace of U.S. economic growth relative to that of other major industrial countries, and the debt problems of the developing countries all have influenced our trade deficit. Our future performance on these counts will determine in large part our success in reducing that deficit.

The sixth element of the President's competitiveness initiative therefore focuses on shaping an international environment in which American knowledge, talent, and entrepreneurial abilities can flourish -- and in which American goods and services can compete freely and fairly both at home and overseas.

The President's program of action in this area covers a wide range of inter-related measures, including:

-- strengthening economic cooperation on a global scale to achieve improved, more balanced growth and the reduction in external imbalances necessary for greater exchange market stability;

-- pressing forward with the strengthened debt strategy to improve both growth and imports in debtor nations; and

-- pursuing an aggressive, comprehensive trade policy that focuses on creating open, competitive markets through vigorous bilateral and multilateral negotiations and tough-minded enforcement of U.S. trade laws.

International Economic Cooperation

During the past year, we have made progress in establishing the fundamental conditions for balanced global growth and a reduction in external imbalances. The dollar has now depreciated substantially vis-a-vis the currencies of the other major industrial countries since its February 1985 peak; two-thirds of the adjustment has occurred since the Plaza Agreement of September 1985. The dollar has declined 40-50 percent against the yen and the deutschemark since its early 1985 peak. The industrial countries have sustained moderate growth, and the non-oil exporting developing countries have turned in a fairly strong growth performance over the past year. Rates of inflation in the industrial countries have, with an assist from the decline in oil prices, fallen to the lowest levels since the 1960s. Key interest rates have continued to trend down. Progress has also been made in reducing fiscal deficits in the major industrial countries to more manageable levels.

Many observers believe external imbalances among the major industrial countries may have peaked last year. The U.S. current account deficit probably reached about $145 billion in 1986 (actual figures due in March), while the current surpluses of Japan and Germany were around $86 billion and $36 billion, respectively. Many forecasters think it likely that our current account deficit will decline this year to around $130 billion and that the Japanese and German surpluses will decline somewhat as well.

The effects of the exchange rate changes over the past two years on our international trade balance have not yet proved as quick or as strong as had been expected from past experience. However, exchange rate changes have contributed to a leveling out of what had been an upward trend in our trade deficit.

Given the great volatility of monthly results, the sharply reduced deficit for December cannot by itself be taken as a clear turn for the better. However, it does cancel out the alarms raised by the sharply higher deficit initially reported for November. It also substantiates our assessment that these monthly Census-basis deficits have held roughly flat for more than a year.

More importantly, we are confident that the cumulative effect of the exchange rate changes thus far will contribute significantly to a reduction of our trade deficit this year.

The challenge before us is to build on this foundation to achieve substantial further reductions in external imbalances. Exchange rates play an important role in the adjustment process, but they cannot and should not be the sole mechanism. If the costs of adjustment are to be held to the minimum, exchange rate changes must be complemented by stronger growth abroad and measures to adjust the structures of our economies.

We have sought to facilitate other necessary corrections of external imbalances through intensified international economic policy coordination. Over the past year, we concentrated considerable attention on strengthening international arrangements for such coordination. Building on the Plaza Agreement of September 1985, we were able to reach agreement on enhanced coordination at the Tokyo summit last May. The first meeting to implement the new process was held last September immediately prior to the annual meetings of the International Monetary Fund and the World Bank. In late October, the United States and Japan announced bilateral agreement on cooperative actions which, as they are implemented, will contribute to sustained growth in the world economy. On several occasions last year, internationally coordinated interest rate reductions took place. We will be building on these accomplishments in the year ahead, recognizing that each meeting will not produce an agreement and each agreement may not result in a major redirection of economic trends.

The pace and pattern of growth in the industrialized countries will continue to receive our close attention. Last year, domestic sources of demand growth strengthened abroad, particularly in Europe. Yet there can be little question that more needs to be done to promote more rapid growth abroad. As external surpluses are reduced, accelerated growth of domestic activity abroad is necessary to maintain even moderate rates of GNP growth.

We will continue to impress on other industrial countries, particularly those with large external surpluses, our mutual need for them to achieve stronger, sustained growth. The alternatives to stronger growth abroad -- unacceptable levels of economic activity in the United States, or exchange rate changes greater than would otherwise be needed, or both -- cannot be viewed lightly in the current international environment.

Responsibility for actions contributing to the adjustment of our external imbalances does not rest with the major industrial countries alone. The newly industrialized countries in Asia have also come to play a significant role in international trading patterns. Open markets contributed much to the development of these economies, and many of the NICs are now ready to be brought into the world trading system as full-fledged participants. One essential element will be that they follow policies that allow their currencies to better reflect economic fundamentals. And they must open their markets to both foreign trade and investment.

International Debt

This Committee is well aware of the close linkages between debt and trade, as well as their common connection to global growth and financial stability. We all have a stake in constructively addressing international debt difficulties -- not via quick-fix gimmicks, but through lasting solutions to underlying problems.

I recognize that it is politically tempting to search for dramatic gestures which could sharply reduce debt service burdens overnight, or significantly increase the financial resources available to debtor nations to import our goods. Across-the-board debt forgiveness, in this light, may have some mistaken appeal, but would ultimately damage both debtor nations and the global economy. External capital would be available to debtors at prohibitive prices, if at all; bank losses would weaken some of our important financial institutions; and U.S. budget and taxpayer costs would increase significantly.

Similarly, calling for massive new lending (by others) to the debtor nations, either bilaterally or through a new multilateral fund, may appear to offer an easy way to boost U.S. exports and growth in the debtor nations. But without fundamental policy reforms, neither U.S. exports nor debtor growth can be sustained for the longer term. Throwing money at the debtor nations won't solve their problems; it will, in fact, worsen their difficulties unless the new financing can be productively absorbed and is consistent with their ability to grow and service debt.

In contrast to these "overnight" solutions, our debt strategy focuses on improving the debtors' growth potential through both macroeconomic and structural reforms, supported by modest new financing essential to meet immediate needs. Despite the relatively short period which has passed since we proposed this debt initiative, considerable progress has been made.

-- Many debtors are already taking important steps toward increasing savings and investment, improving their economic efficiency, privatizing public enterprises, and encouraging the return of flight capital.

-- The IMF has negotiated new standby programs with 8 of the 15 major debtors since October 1985, including new loan commitments of about $4.7 billion.

-- The World Bank has negotiated $2.9 billion in new policy-based loans with 10 major debtors, and has discussions underway on nearly $5 billion in additional policy-based loans. Aggregate World Bank loan commitments to these debtors increased by 40 percent during its fiscal year 1986, and a substantially larger share of loans is now based on structural policy reforms.

-- Finally, the commercial banks are also moving to make new loans available, as exemplified by the recent $7.7 billion package for Mexico and a $320 million new money package for Nigeria. Nearly $70 billion in debt reschedulings have been negotiated with the major debtors since October 1985. A number of other financing packages and reschedulings are also now under discussion.

This is a start -- a good one. We hope for further progress, but realistically must recognize that it will be gradual and will vary among nations, depending upon their own determination to implement growth-oriented reforms and the continued active support of the international community. That is the task before us, and the only true solution to international debt problems.

International Trade

Renewed economic cooperation and the strengthened LDC debt strategy must be coupled with a hard-hitting trade strategy, the third aspect of the President's initiative to shape the international economic environment. This strategy builds on the pillars of our trade policy to date -- a tough position on unfair trade practice at home and abroad; market liberalization through results-oriented bilateral and multilateral negotiations; and rejection of protectionism, in all its guises, as the single greatest threat to the competitive future of America.

The President's initiative encompasses the following:

-- Aggressively Opening Markets. The President will not tolerate closed markets, trade barriers, and unfair subsidies which deny American firms a fair chance to compete. The Administration will expand its efforts to open foreign markets through vigorous bilateral and multilateral negotiations and by using our trade laws to eliminate unfair trade practices wherever they occur.

-- Negotiating a Free Trade Agreement with Canada. The Administration is now engaged in historic negotiations with our largest trading partner, Canada, on a free trade agreement that will improve commercial opportunities on both sides of the border and serve as a model for trade liberalization on a global scale. We will work with the Canadians and Congress to conclude an agreement in our mutual interest. We also urge private sector parties from the United States to work closely with us, so we can forge an agreement that best serves our economic interests.

-- Negotiating in the GATT. The President will work to ensure that the laws of the trading system are relevant to the commercial realities of the 21st century. The United States Trade Representative will press hard for quick results from the Uruguay Round of multilateral trade negotiations in areas critical to America's competitive future, including agriculture, services, intellectual property rights, and investment.

-- Attacking Foreign Predatory Financing. The Administration has aggressively used the "war chest" monies provided last year to attack foreign predatory financing practices. To support these efforts and to put our trading partners on notice that we will use our full authorities to counter foreign subsidized credit offers, the President has asked Congress for the additional $200 million promised for the "war chest."

-- Improving U.S. Trade Laws. We will introduce comprehensive statutory changes to improve our trade laws in ways that will enhance our ability to meet the challenges from abroad without erecting protectionist barriers at home. The President's proposals will include:

- seeking negotiating authority for the Uruguay Round;

- replacing the antidumping law with a new, predictable pricing remedy to cover products from nonmarket economies and tightening antidumping and countervailing duty laws through new anti-circumvention provisions to prevent evasion of duties;

- amending Section 301 to establish a 24-month deadline on dispute settlement cases and to improve coordination with Congress through reports on the commercial effects of Section 301 cases;
- establishing reciprocal access to foreign markets as an additional factor in consideration of a Section 301 case;
- amending Section 201 to provide expedited relief for perishable products and to create additional options for relief, including multilateral negotiations and regulatory relief; and
- seeking improvements to the Export Trading Company Act and a reform of the Foreign Corrupt Practices Act.

I know that this last set of measures -- improving U.S. trade laws -- is of special interest to your Committee. Ambassador Yeutter, the U.S. Trade Representative, will discuss these measures and recommendations in greater detail in his testimony.

For my part, I want to emphasize the Administration's readiness and willingness to work with you to make the necessary changes in these laws. We need to keep in mind that our trade laws have proven to be effective instruments for opening foreign markets and defending Americans against unfair practices on the part of our trading partners. A few changes are needed, as I noted above, and we will strive to make these improvements. However, regardless of the reforms that need to take place, the basic principle behind these laws stands firm: competitive markets serve America's interests best.

It is clearly the turn of our exporters to benefit from greater growth abroad and a more reasonably valued dollar. If they are to have access to markets abroad, however, we must maintain the openness of our own markets. We could not pick a worse time than now to unfurl the banner of protectionism.

We urge the Congress to measure proposals against five key considerations. Our actions need to:

-- facilitate the competitiveness of U.S. industry;

-- conform to our international obligations;

-- enhance our leverage in the Uruguay Round and in other international trade negotiations;

-- avoid provoking costly retaliation against U.S. exports;

and

-- avoid prompting our trading partners to enact mirror legislation that would harm U.S. exports.

Some of the trade proposals we have seen from the Hill conflict significantly with these principles. Without implying that these are the only troublesome notions that have been suggested, I should stress today that the Administration would have to resist the following legislative measures:

-- A general import surcharge. Such a surcharge could spur inflation, prompt retaliation by our trading partners, and hurt American industries that rely on imported inputs.

-- Sector-specific protection, such as establishing import quotas for individual products. This route not only has all the drawbacks of a surcharge but also could be unfair to industries not receiving favored treatment. The textile quota bill -- which the President vetoed -- is a good case in point.

-- Mandatory retaliation. Mandatory retaliation -- linked, for example, to a country's bilateral or global trade surplus -- is too inflexible. Threats can be useful to negotiate a solution, but a rigid, statutorily mandated approach that dictates to foreign governments can make them less likely to agree to reduce barriers and more likely to dig in and counterattack by closing their markets to U.S. exports.

-- Limits on Presidential discretion. If we are to be successful in negotiating more open markets, the President needs the flexibility to bargain. The President should have at his disposal a full range of policy tools in order to promote open, competitive markets at home and abroad. If our negotiators are constrained by legislative requirements to take certain actions in specific situations, they can be outmaneuvered. Or the negotiating process will break down, producing protectionist results for everyone. Without sufficient authority, U.S. negotiators will not be able to obtain concessions.

Let me reiterate that the four proposals about which I have just spoken are not the only ones which are troublesome to the Administration. During the course of your mark-up, Ambassador Yeutter will be providing detailed comments on which provisions the Administration can accept and which it cannot. My point today is that the foregoing proposals, like some others being weighed, are counterproductive. Such approaches are compatible with a rigid, high-cost market environment relying on protectionism. America has prospered for 200 years because it has been a dynamic, flexible environment -- which has blended competition and cooperation to forge a unique economic union. We would be mistaken to reject this legacy.

Conclusion

There is growing recognition that the United States faces new competitive challenges as a result of fundamental changes in the world economy. The United States must meet these competitive challenges to maintain its economic strength and world leadership. The President's Competitiveness Initiative offers a program of action for ensuring that America is well prepared to meet these challenges and to enter the 21st century confident and strong.

I know that I and others in the Administration look forward to working with the Congress on this program. Together we can seve the public interest by encouraging the evolution of a vigorous, vibrant, forward-looking society -- one worthy of our heritage as a great trading nation.

The CHAIRMAN. Mr. Secretary, I note that you are meeting Saturday with the Group of Five to discuss the currency exchange rates, and then on Sunday with the Group of Seven, which includes Canada and Italy.

I have long proposed that we try to do something about getting the dollar back in balance, and I have been very pleased to see what you have done and the initiative you have taken in that regard. But I am deeply concerned about what to do and how to do it, when it comes to other nations that are not a part of the Group of Seven—for example, Taiwan and South Korea, which has pegged its won to the dollar. I have seen no give in their currencies, and all I can see happening is nations like that rushing in to fill the void. We are right back where we started, except other culprits are involved in the process.

What can you do in that regard? And how can the pressure be put on? What do you have in mind?

Secretary BAKER. Well, Mr. Chairman, what you can do is discuss with these countries the importance of their taking their rightful place in the world economy based on their economic performance. We have been doing that, and we are continuing to do that, and there has been, in fact, movement in the Taiwan dollar. I don't know the exact percentage, but I think it is 11 or 12 percent.

The CHAIRMAN. That is about right. But on the South Korean problem, virtually nothing has changed.

Secretary BAKER. Less movement as far as the South Korean won is concerned. I think we have to recognize that South Korea has been a major debtor nation. It is generating a trade surplus for the first time, really, relatively recently. It is on the forefront, out there on the front lines in terms of our national security interests, as well. The question is, how far do you go, Mr. Chairman, and how much pressure do you bring?

Again, I think this is a good example of what I meant in my statement when I say I don't think we should try and mandate legislative solutions to the questions of exchange rates. These are things that have to be carefully worked out through negotiation and conversations back and forth with these countries, taking into consideration all facets of their relationship with the United States.

We recognize the problem, as I indicated in my statement, we are talking to them, we expect to continue to talk to them and perhaps to other countries as well.

The CHAIRMAN. Mr. Secretary, talking to them is fine, but in all candor I don't expect them to do anything, unless you find a way to really pressure them. I have a hunch that you are using quite diplomatic language here, because I don't see how it is brought about unless you do more than ask them to exercise leadership and measure up to their responsibilities. I think that's the real world.

Secretary BAKER. Well, Mr. Chairman, I would like to say by way of defense, if I might, that we are doing more than that; the question is: How public should these discussions be? How productive is it if they are conducted in public? And that sort of thing.

The CHAIRMAN. All right. I just want some comfort on that issue. I want to understand that you are in there pushing, and pushing hard.

Secretary **Baker**. All right.

The **Chairman**. I also get deeply concerned, when we talk about a free market system, that in some of these areas there is just no such animal. If we look at agriculture, the common agricultural policy of Europe, then I see what is happening to our farmers in this country, and it is absolutely outrageous. There is no way that you can see the European common agriculture policy paying 27 cents a pound for sugar to their farmers and then dumping it on the world market for 4 or 5 cents, and see devastation in Central America in a labor-intensive industry, and think in any way that those Third World countries are going to be able to compete with that—they can't.

And yet you have tremendous political pressures within the European Community from the farming population pushing hard for those kinds of subsidies. Frankly, I don't see that issue resolved unless we find some way to arrive at some kind of a bilateral agreement with Europe, and perhaps other countries. But the biggest subsidies are in Europe, and they have become a great exporting group of nations that are really devastating commodities worldwide.

Secretary **Baker**. I think, Mr. Chairman, you have put your finger on what is the biggest problem in world trade, and that is the problem of agricultural trade.

I don't think, though, that there is a way that we could legislate a solution to that. I agree with you when you say we've got to do it through bilateral and multilateral discussions and negotiations.

The **Chairman**. I don't think we can legislate a solution to it, either. But I think you are going to have to develop some kind of a bilateral agreement with Europe in that regard to protect the rest of the nations of the world, not just us.

Secretary **Baker**. I think we are, too, Mr. Chairman. And I am quite encouraged by the fact that, at the insistence of the United States and Canada, primarily, the issue was put on the table at the Economic Summit in Tokyo for the first time ever. Heretofore the European countries have been unwilling to have even a discussion of agricultural trade matters. We now have ongoing talks with respect to this problem.

We are not without fault here in the United States, as I know you would agree. We, too, subsidize, and we subsidize to a significant extent.

The only solution to this problem, though, is to work it out bilaterally with these countries or multilaterally. We cannot handle the problem, I don't think, in this country unless they are willing to handle it over there, and they can't handle it over there unless we are willing to join in over here.

The **Chairman**. They are not going to do it over there unless we take them headon, with the same kind of practices, to a degree, that they are indulging in. Hopefully, we would then both back off and have some sense in our policy so that taxpayers can afford it and it keeps prices competitive.

The five-minute limitation is a very onerous one, particularly for the chairman. [Laughter.]

The **Chairman**. Let me recognize the order of those who have arrived: Senator Danforth, Senators Roth, Packwood, Baucus, Rockefeller, Heinz, Mitchell, Daschle, and Durenberger. With that in mind, I will now call upon Senator Danforth.

Senator DANFORTH. Mr. Chairman, thank you very much.

Mr. Secretary, I appreciate your being here, and I appreciate your comments and those that were made by the President during the State of the Union message. I know that there has been some debate within the Administration as to how active the Administration should be in working toward trade legislation.

I think the good news is that you are now on the playing field, and we do have an opportunity, I think, to work out something that is constructive.

To me, the challenge is to find a middle way in trade policy which is tough, which is meaningful, but which is not protectionist, a middle way between doing nothing, a very passive approach to trade problems, and to erecting the trade barriers and essentially taking the position that the United States can't concede any more, that we are not good enough to compete, that we don't want to compete, and that we just want to sell to ourselves.

The question, I think, that we are going to be facing is, how can we devise trade legislation which makes it possible for the United States to compete more effectively, if there are products—and there are many—where we do have the comparative advantage, and where we do have the state of the art?

If we are going to operate in an international environment, we are going to have to have the opportunity not only to buy products from other countries but to sell our best products on foreign markets. And that is where we have felt stymied. Everyone has a list as long as his arm about the difficulties of doing business with Japan—that we can make baseball bats, skis, silicone, beef, citrus, anything, whether it is the best in the world or not, and somehow we are just not able to do business in the Japanese market.

We have also had problems with the Europeans. You and I have discussed the Air Bus situation, the fact that we do have the best available product, and that still we are being undercut in that market.

So I think the big problem we are going to have is, how do we develop a system which says that we can compete if the rules are fair? How do we create rules that are fair, and how do we create rules that are enforceable?

I think the problem we are going to have with the Administration—and this is what I would like you to address—is how can we assure the American people that the rules of international trade are going to work to their advantage, that they are going to be enforceable, and that they are going to be enforced?

Particularly I call your attention to a couple of the items that you said the Administration would oppose. One is mandatory retaliation, and the other is limitations on Presidential discretion.

In the hypothetical case of a clearly unfair foreign trade practice, and say a future Administration that takes the position that any retaliation is tantamount to protectionism, how can we develop some sort of thing that assures the American people that, if they have a real grievance against an unfair trade practice, they can get satisfaction? Or is it the Administration's position that any President should be able to say, "Well, we don't care how egregious the unfair trade practice is, we don't care how unfair the foreign practice is, we believe that for foreign policy reasons" or for other reasons "that we are not going to do anything about it"?

Secretary **Baker**. I think there may be circumstances, Senator Danforth, where it would not be inappropriate for a President of the United States to perhaps reject relief on grounds of purely national security considerations.

We are going to be sending up some improvements—we think they are improvements—in section 201, section 301. In 301, we are asking that the Congress amend it so as to use reciprocity as an additional factor or consideration; that is, give the President the authority to use it—not to mandate it, but to give him the discretionary authority to use it—in a 301 case.

How do you get satisfaction? How can you assure someone in our country that these practices are going to be taken on head-on? I think you assure them by pointing to the record, if I may say so, of this Administration, at least over the last two years. This is the first Administration in the history of this republic where the President of the United States has taken as aggressive a posture as he has taken, utilizing the tools, enforcing our unfair trade laws, if you will. He is the first President in history to self-initiate section 301 cases—he has self-initiated about seven or eight of them, I think, successfully against Japan in the case of cigarettes, and some other things. We have granted more import relief under section 201, Senator, than any Administration in 30 years.

I think that what you have to do in this situation is avoid, if I may say so, the temptation to try to mandate or specify in minute detail every circumstance and situation and instance in which retaliation has to be taken, and rely upon political pressure, and rely upon the fact that no Administration, in my view, is going to let the economic situation become prejudiced by the maintenance of an unsustainable trade deficit such as we have today.

The bottom line is, we need to improve some of these provisions; but basically we have the tools, if we will use them, and I will submit to you, Senator, that we have darn well been using them over the past two years.

Senator **Danforth**. I think you have, too, over the past two years. I think people could point to the previous four years and suggest that maybe some future Administration could take very much of a hands-off position with respect to redressing real grievances in international trade. And the issue is: Can we fashion something that provides a greater assurance that, when the rules are broken, the penalties will actually be walked off those who are violating the rules?

The **Chairman**. Senator Roth, would you like to make your comments?

Senator **Roth**. Thank you, Mr. Chairman.

First, I want to say I agree with you that this Administration, this President, has been much tougher in enforcing many of the present laws, and I particularly want to congratulate you, Mr. Baker, for your leadership in this international area. I think that much that you have done has been very refreshing and extremely helpful.

I was interested in your comment on reciprocity. It does seem—as one who believes that we must continue the policies of the past, of liberal policies—that we do have something that can be used by the Administration very effectively, and that's the American market, still the greatest market in the world. And somehow, in bargaining, I think we ought to make it clear that we are going to reward those who help us promote trade and those who have one policy for their exports and another for their imports to act accordingly.

I am not going to ask you to comment on this, but I am going to ask you, as I am Mr. Yeutter at a later time, that I do think some serious consideration should be given to reorganizing the trade function of this government. I am not suggesting that it ought to be changed during the remaining years of the Reagan Administration, but in 1988 of course there will be an election and there will be a new Administration the following year.

I think because of the importance of trade that we should give some serious consideration—I am not necessarily talking about a Department of Trade or what, but I do think we should give some very, very serious consideration as to how we can strengthen our hand in such matters by better organization and making trade a key factor.

Now, specifically I would like to go to trade adjustment and say I am pleased that the Administration has now come out for work retraining. I have been a long-time champion of that.

My proposal and that of Senator Moynihan differs in two particulars. I agree with you, we don't want an import fee, generally speaking; but I do think that it is important in negotiations, in GATT negotiations, that we negotiate the right of some small fee—not more than one percent—be permitted as a means of financing the cost of worker adjustment. It does seem to me that there is equity in that. After all, those who are getting the advantage of liberal trade policies ought to be willing to pay the price of those that are negatively impacted, the workers who lose their jobs.

Your proposal calls for $600 million, and in these days of the deficit I am not sure just how we are going to get these funds from general revenue. But I would like to have your comment on that, as well as a second difference between our two proposals: We would provide considerably more unemployment compensation during the retraining program.

It is my understanding that even under the current TAA program it takes some extended time before workers begin to receive benefits. Retraining under the Administration's proposal would most likely be offered to workers after they had run out of their state unemployment insurance to fund their daily needs. Now, we provide an additional 52 weeks, and I would like to have your comments on those two specific proposals.

Secretary **Baker**. Well, Senator Roth, I am not sure I am the best witness on that. Those proposals are administered of course through the Department of Labor, and they worked closely with OMB in developing them.

Let me simply say this, though. I guess I am a good witness on the question of an import fee to finance it, and my answer to you on that would be that that is a very slippery slope to start down. It is one thing to say, "Well, this is only one-tenth of one percent, or it is a half of one percent, or it is one percent," but when we start putting on across-the-board import fees, we have problems with respect to some of our international obligations, and we invite the same kind of practice.

Senator ROTH. I am suggesting, Mr. Secretary, that it be negotiated under GATT, so that it would be legal, a recognition of a duty, a responsibility, to impacted workers. I am not suggesting that you do it without that context.

Secretary BAKER. I think if it were negotiated under GATT, it would remove some of our objection to it; but I don't think that we would be in favor of it, because we think it is a very, very slippery slope.

Senator ROTH. I would ask that you give further consideration, and I would like to discuss that with you.

Secretary BAKER. Yes, sir.

The CHAIRMAN. Thank you very much.

Senator Packwood?

Senator PACKWOOD. Mr. Secretary, when you enter into negotiations, either multilateral or bilateral, you are going to be dealing, usually, with either democracies—often parliamentary democracies—or with dictatorships. In either event, if it is a parliamentary democracy you have got a majority party and majority control of the lower house of parliament, and they can deliver on their agreement. Dictators can deliver on their agreement.

What is going to happen to your bargaining authority in negotiating if those with whom you are negotiating—and they have to make some tough decisions in their domestic policies—think that the agreement that is reached in all likelihood or possibly would be overturned by the Congress?

Secretary BAKER. It makes it tougher, Senator Packwood, to negotiate multilateral agreements, or for that matter to negotiate bilateral agreements, because of the nature of our political system.

Senator PACKWOOD. A second question, on 201: You have got an ITC finding of injury but no allegation of unfair trade, just injury. In that circumstance, if you were to mandate that the President had adopted some remedy, whether it was the ITC's or otherwise, can that be called anything but outright protection?

Secretary BAKER. No, sir, it would be outright protection.

Senator PACKWOOD. On 301—and this is the one I find bothers the members more than almost any other—a desire to want to say something to some country about, "You had better let us in your markets, or we are going to retaliate," and a fear that that would be bargained away by a President, by a State Department, more concerned, disproportionately concerned, with international affairs as opposed to economic affairs. And I understand that frustration.

The argument that Congress will put forth is, "We will strengthen your hand if we write in a requirement for mandatory retaliation, or the equivalent," and then you will be in the position to go to our bargaining partners and say, "look, folks, the law says that we have to retaliate unless you do something equivalent."

What is the answer to that argument, that it would strengthen your hand if you had statutory mandatory retaliation?

Secretary **Baker**. The answer to that, Senator Packwood, is that mandatory retaliation is really too blunt a tool, and on balance it is more likely to hurt us than it is to help us.

Let me give, if I might, an example. We recently settled a very serious dispute with the European Community having to do with the accession of Portugal and Spain into the European Community. We settled it through a negotiation or an agreement that gave us something in the agricultural sector and also gave us something in the industrial sector. If we had been required under legislation mandating retaliation there, strictly, solely and exclusively in the agricultural sector, I dare say that that agreement would not have been reached, and we would have seen a first class trade war as a consequence of that dispute.

Senator **Packwood**. It would not have to be sectoral retaliation. And bear in mind, I am not arguing for the mandate, but I am trying to be a devil's advocate.

Korea won't let us sell french fries, and they are pretty harsh about insurance; so, we say to them, as a mandated reaction—we don't have to pick exactly the same industry—you can say, "All right, we are not going to let you sell any Hyundai's in the United States until you let us sell french fries and insurance policies." So, it isn't sectoral.

And then the argument goes further. If we said that to Korea, and indeed if once we had to use it—the one time in 10, because it's a trump card—you would have a much easier time selling computers in Brazil, and rice in Japan, if they had seen that you use that retaliatory power just once.

Secretary **Baker**. Yes, sir, but the problem with it is, it forecloses the opportunity, I think, to move across sectors, it locks you into less flexibility—you have less negotiating authority, you have less flexibility. The response would more likely be retaliation, which in turn would trigger counter-retaliation. And the one lesson that I think we have learned in our more aggressive period here of self-initiating 301s and granting import relief under 201s is that retaliation is not cost-free.

We raised tariffs here not long ago, as you know, in the shakes and shingles issue involving the Canadians, and they hit back on a number of different products, as far we were concerned. So, that would be my answer to your question.

Senator **Packwood**. I would agree with you. I don't know how many times I have heard Senator Danforth say, correctly, that we cannot manage trade policy in the Congress. I think it is a fair argument, to have a debate about protectionism versus nonprotectionism. If the Congress wants to come out protectionist, and that's the policy, and they want to impose it on the country, that's what happens in a democracy. And that is what the debate ought to be.

And if we decide that we are going to try to continue a policy that we have been following for 50 years of trying to have lower barriers, trying to eliminate restraints, then that is the policy, and I think beyond that we have to depend upon the good faith of the President to try to carry that policy out.

Secretary **Baker**. Give us the tools, put pressure on us to use it as we have seen over the past two years, but don't mandate it, because you cut down significantly on the flexibility of what can be achieved.

The CHAIRMAN. Thank you, gentlemen.

Senator Baucus?

Senator BAUCUS. Thank you, Mr. Chairman.

Mr. Secretary, I think that the tension in this hearing—that is, the questions that Senator Danforth asked on how can we assure the American people that the Administration in this country is going to take needed action, or the question that Senator Packwood addressed: that the Congress really can't manage trade policy as well as the Administration—all the tension in this hearing, it seems to me, comes down to two points:

Number one, I think that, unfortunately, over the years—not just this Administration but the prior Administrations—there has been too much confrontation between the Administration and the Congress, and in many senses too much partisanship. You know, it used to be, that foreign policy was bipartisan. Presidents would meet with the members of Congress, there was more give and take, and there was much more a sense of cooperation between the two major branches of Government, at least in setting policy. That has gone by the boards now. I think there are many in this town who would say that, unfortunately, this Administration is one of the most confrontational in dealing with Congress, that it is one of the most partisan in dealing with Democrats in the Congress. You hear that all over in this town.

I think that, frankly, the time has come when we can indulge less in confrontation between both ends of Pennsylvania Avenue, and indulge less in partisanship.

But the fact is that we have this stupendous trade deficit. We are now a net debtor country. All the trend lines are wrong, they are in the wrong direction economically, we have got to get our act together, get our house together, and I am wondering about the degree to which the Administration is truly—not just lip service—going to try to deal with the Congress on a less confrontational basis and in a more cooperative tone.

I think that some of the mistrust here is due to the confrontation, with this Administration historically labeling so much up here as "protectionism."

The second point, if I may Mr. Secretary: I think the second reason for this tension is the Congress's perception that the Administration still not tough enough, not only in trying to get other countries to lower their unfair barriers to trade—sure, we are not Simon-pure, we don't wear a white hat, but still there is the perception that our color of gray is a little lighter color of gray than the color of gray of a lot of other countries. We are not getting tough enough. The Administration is not tough enough, still.

And second is the perception is that, although the Administration is coming along now with competitiveness, and that is a major improvement with a lot of good initiatives, it is still not enough.

The belief here is, I think, that in the past, although foreign policy drove economic policy, because our country is so interrelated now economically with other countries, that economic policy is going to have to drive foreign policy more.

I am wondering if you can address two questions: What can the Administration do to come along a little more and be more cooperative? And second, what can you do to get a little tougher? How can we help you get a little tougher, not only in unfair foreign trade practices but more in competitiveness?

For example, the Administration talks about ending illiteracy by the the Year 2000. The fact is, the Administration is cutting education expenditures by $5 billion in the budget. I think our R&D effort is more in SDI than it is in civilian R&D. So, I wonder if you could address both of those questions?

Secretary BAKER. Well, addressing your questions in the reverse order, if I might: Number one, as I indicated in my answers to Senator Danforth, we have been tougher in aggressively pursuing our unfair trade laws than any Administration in 30 years, and this is the first President in the history of this republic to self-initiate unfair trade cases. So, over the past two years, in terms of utilizing the laws that are there on the books, we have a better record than any Administration going back 30 years now.

Senator BAUCUS. I think it is better, but the feeling here is that it has to get quite a bit better.

Secretary BAKER. Well, I can't speak to the feeling, Senator; all I can say is that it is in the record.

Senator BAUCUS. I think you will find a near universal feeling on this panel on that point, I think. There is not much division on this panel. We are bipartisan.

Secretary BAKER. Well, let me finish the answer to the question—still on the second question you asked, some have accused us, quite frankly, of being too tough in certain areas. They are accusing us of doing something that we really ought not to do, "My gosh, you are using the dollar as a weapon—you shouldn't be doing that." So, it is not a uniform view, that we are too soft. Some people think, to be very honest with you, that we have been too tough in some areas of this problem.

The record is, we have been tougher than any Administration in 30 years.

Now, on the issue of cooperation: We mean it when we say, when everybody from the President of the United States on down says, that this is a major problem confronting this country, and it is not going to be solved without cooperation on a bipartisan basis between the Congress and the Executive Branch. Everybody in this Administration from the President on down has said, "We want to work with you this year to solve this problem," and the reason we do is twofold: One, it is a major problem. It is politically and economically unsustainable to run a $170 billion trade deficit.

But the second reason is, quite frankly, we run a serious risk here of an overreaction that would take us down the path that Senator Packwood spoke to, and that is the path of protectionism, a path we have walked before in the history of this country, once before, with disastrous consequences.

I don't guess anybody would argue, that anybody in this room today would argue, that one sure way to cure the trade deficit in the United States would be for us to have a recession. And it would be the worst thing in the world for the world, and nobody wants that. But if we are too strong here and we resort to protectionism, the same thing could happen to us that happened in the late-Thirties.

So we are honest when we tell you—and we are telling you in good faith—that this is a major serious problem confronting this country, and we should work it out together, cooperatively, on a bipartisan basis.

Senator BAUCUS. Well, my time is up, so you get the last word. Thank you.

The CHAIRMAN. Senator Rockefeller?

Senator ROCKEFELLER. Secretary Baker, I have the feeling that the two witnesses this morning are the two best people in the Administration in terms of trade. And having said that, I also have the feeling that in the discussion this morning, and in the recent general discussion, we are engaging ourselves in an enormous Kabuki dance.

We talk about "going down the wrong path" if we do the protectionist deal—and I agree with that. But the problem now in this city is that the word "protectionism" means anything that implies change at all.

Now, we have a $170 billion trade deficit. I think that is a substantially wrong path, with about a million more workers out of work every year and 50 percent of those who get jobs again be making $7,000 or less. That is a wrong path by almost anybody's definition; the Smoot-Hawleys, I presume, would agree with that, also.

So, you say, "Give us the tools," to Senator Packwood. But then you say, "Don't give us tools which are mandatory—no limitations, no retaliation." On the other hand, we have a President who, as you say, has been very aggressive on section 301. I would point out that I think the section 301 cases come to a total of about 11, they have been sector-specific in individual countries—leather, for example, in Japan—so 11 is not very much. The dollar flow in trade which has been affected by those cases is very minimal; they take approximately a year; they don't send out more than symbolic signals.

So now, we can't be protectionist, we can't retaliate, we can't put limitations on the President. Then, as Senator Baucus said, you look at competitiveness. Well, if we open all of the barriers from other countries, which is what we all want to do on a bipartisan basis, then everybody says, "We'll take off $25-30 billion," so that takes us down to $140 billion. The dollar/yen exchange and the dollar/mark exchange is maybe another $10-15-20 billion, so we are down to $110 billion. Where are we leading?

If we are going to do a competitiveness number, which the President is for and which we are for, as the Senator from Montana indicates, we need improvement in our education system. We have very little time. The budget deficit, perhaps you can get that down to $50 billion. The trade deficit you have got to get down to zero before you start making any progress at all—we have got to get it on the plus side.

I guess what I am really saying is, why don't you want us to give you stronger tools? I mean, is this ideological warfare that we are in, that nobody dares talk about toughness with other countries or with ourselves? I mean, why don't you want us to give you the power to retaliate—and I say "retaliate"—in a trade negotiation if you, for example, or Clayton Yeutter believes that it will be successful for that particular negotiation? Why the fear of doing something which is more than we now have?

Secretary **Baker**. Well, Senator, let me answer that by saying, we have the power. We have the power today. What we are suggesting is that you not mandate it in certain very narrowly-defined prescribed situations.

But if I also might, let me answer the first part of your question, in which you said that we are coming up here saying "protectionism is implied by any change at all." Nothing could be further from the truth. We are sending you a 1,600-page bill today that attacks this problem across the board, and it is a problem that is a great deal larger than just trade, and just changes in our trade laws.

Included in there are, we think, some very good changes in the trade laws, including the use of reciprocity in section 301, which doesn't exist now.

We are not are suggesting for one minute that anything that implies changes is protectionist; in fact, we are sending up some very, very specific and comprehensive legislative proposals which we hope the Congress will move on.

Senator **Rockefeller**. Let me give one more example before my time runs out: Semiconductors. We had 100 percent of the market, and we are now down to 10 percent. There are approximately 20 sensitive military systems that we make which depend upon, at least in part, foreign semiconductors; products that we do not make in this country. There is no way in which you can argue that the semiconductor industry that spends 83 percent of its pre-tax profits on R&D, is not doing every single thing it possibly can.

Now, according to what you have been saying this morning, they are going to have to make their own way in this country. A lot of people would say that if they are unable to make their own way successfully, we are going to become truly dependent on others, not only in terms of military and information systems, but also commercial competition.

Now, it is an industry in trouble. It is not an industry particularly strong in my state; but does the government in all of this have no role in terms of looking at their future?

Secretary **Baker**. No, absolutely not. And we have had a number of meetings of our economic policy council considering the very problem you have just pointed out. We have negotiated an agreement with the Japanese in particular having to do with semiconductors. There is a question now with respect to whether that agreement is being adhered to by Japan.

Senator **Rockefeller**. That is correct.

Secretary **Baker**. And that is something that we are likewise addressing as you and I sit here and talk this morning. And if it isn't being adhered to, we will take some action. But we have the tools to take the necessary action.

The reason we got the agreement in the first place, Senator, is because we threatened action. The threat of action is very important. It is important to have it, so that you can exercise it and come to some agreement by way of negotiation. It gives you a great deal of flexibility. If a country is then not going to live up to it—and I am not passing judgment, because I am not personally familiar with whether they are living up to it or not, but if they don't live up to it—we will in fact retaliate. But the reason we got the agreement in the first place was because we threatened retaliation.

Senator **Rockefeller**. My time is up, Mr. Chairman.

The **Chairman**. Senator Riegle?

Let me once again repeat the list of arrivals. It is Heinz, Riegle, Mitchell, Daschle, Durenberger, Chafee, Wallop, and Bradley.

Senator Riegle?

Senator **Riegle**. Thank you, Mr. Chairman.

Mr. Secretary, we have Chairman Volker up at the Banking Committee today talking about monetary policy for the coming year, so many of us have to go back and forth between committees this morning.

I want to say for the record how much I respect you and the job you have done over a long period of years in the Administration. And the fact that I have some critical observations to make about trade strategy or the absence of a trade strategy should not be taken in any personal vein, because I admire very much the job you are attempting to do.

I have two charts that I brought with me today that I want to just quickly show you, if I may.

Secretary **Baker**. Sure.

Senator **Riegle**. This first chart illustrates our trade performance over the last several years. You will notice, if you can see the years at the bottom of the chart in the early Seventies, the line at the top is the balance of trade. We were pretty much holding our own.

In the late Seventies we came down into a deficit position; the oil problem had a lot to do with that. But then, starting about 1982, we really had a hemorrhage starting to take place in our trading relationship, and this is current through the end of last year. This illustrates a $170 billion trade deficit which, as you know, was our performance. But I show you on this chart, because I want you to see the dynamics if you have a chart that is to scale.

I show you this first, in order to then show you this: If you think of that as sort of the income statement on trade, this is the balance sheet. As the Secretary of the Treasury, I know you are concerned about this, and it relates to currency values and so forth.

The thing that I am struck by is that I noticed that we were a creditor nation going all the way back to 1914, until two years ago when we moved into this debtor-nation status. We have now passed every other nation on the debtor-nation list; we are number one. But the important fact is, we are adding new international debt right now, this week, at the rate of $1 billion every two and a half days. That is what the performance is. The New York Fed estimates that by 1990 we are going to owe the rest of the world $1 trillion. This trend line is just continuing to plummet in this direction.

Now, we have never been in this situation before, but it seems to me that after all of the verbiage is put aside, the bottom line in terms of the effectiveness of our trade strategy is represented by these two charts—a huge trade deficit, the worst in history last year, and now what I consider to be a basic impairment of our international balance sheet. And I think this presents a new kind of problem which has, I think, great dangers for the future.

I just asked Paul Volcker about this upstairs. He is obviously very alarmed about this condition, as I trust you probably are as well. But I don't understand how we can go with any policy on the margin that doesn't fundamentally turn these lines around—and I don't mean just shift the angle of the line slightly, from this kind of a tremendous descent into this debtor's hole that we've got here, but something that stops this and actually turns these numbers, and turns them quickly. I am talking about an ability to level this thing off and start to work out of this hole within six-nine-twelve months.

Secretary BAKER. Senator, you have pointed up the problem very vividly, and—as in my answer to Senator Baucus—we are absolutely as concerned as you are up here in the Congress about solving this problem of our trade deficit.

I have said many times—and I have said it for a long time, going all the way back to before the Plaza Agreement in 1985—it is politically and economically unsustainable, and that is what is generating a lot of that red stuff you see there.

And you are quite right when you say you can't deal with it at the margins; but if you want to see that red stuff get a lot bigger, if we kick off a big trade war that we don't win, and if the world—if I may say so—if the world goes protectionist with the same disastrous results that we saw in the Thirties, you will see that red thing about double or triple what it is now.

So, we have to be very careful, and we have to address it for what it is, which is more than just a merchandise trade deficit problem. I know "competitiveness" is a buzzword and all of that, but it is a problem of competitiveness.

You were over at the Chairman's testimony and you missed my opening statement, where I outlined what the President suggests we do. It is comprehensive, and it is across the board, and one of the things is dealing with the fiscal deficit, but we ought to do a lot of other things.

We ought to deal with product liability, Senator, which puts us at a great disadvantage; antitrust law reform; a whole bunch of other things that helped create that red stuff.

Senator RIEGLE. I agree with you that we have a whole series of moves to make, and I will go even further than that: I don't want to see us have to enact trade legislation here; but, I will tell you frankly, and you will hear it from members of both parties, the reason the congress is going to do that is that what might have been done by the Executive Branch—in its seventh year now—to do something about these trend lines has been insufficient and it hasn't worked. You can give a lot of reasons why, but the numbers are irrefutable.

If you just take three countries—Japan, Korea and Taiwan, and the enormous bilateral deficits that we have with those countries. Why haven't we been able to turn those around? Here is the value of the dollar going down 40 percent against the yen; our trade deficit with Japan has gone up.

We have a slightly different problem with Korea and Taiwan—enormous bilateral surpluses with those countries in their favor. Why hasn't something been done about that?

Secretary **Baker**. Well, for one thing, as you know, exchange rate changes take a long time to move into the trade figures, and the——

Senator **Riegle**. Well, they sure shouldn't work in a way that their situation gets better and ours gets worse.

Secretary **Baker**. Oh, no, that is exactly the way it does work; that is the J-curve effect, it gets worse before it gets better. The economists tell us it takes 18 months, 12 to 18 months, to see exchange rate changes translated in the trade figures. We are 16 months away from the Plaza Agreement. We had begun to see our trade deficit level out—at least level out. If you look at it over a 6-month period, it at least isn't getting any worse. I happen to think that that is in part, at least, due to exchange rate changes.

We also think we are going to begin to see it come down some, Senator Riegle, this year—not enough. That is why we need to do more. We need to do more than just deal with exchange rates; we need to deal with it in a comprehensive way. And that is what we are suggesting with the legislation we are sending up here today.

Senator **Riegle**. My time is up, Mr. Chairman.

The **Chairman**. Thank you very much, gentlemen.

Senator Mitchell.

Senator **Mitchell**. Thank you.

Mr. Secretary, just a few days ago, a manufacturer of children's apparel announced that it is closing three factories in Maine, causing the loss of 1,000 jobs, many of them held by individuals for many years and in some cases decades. One of the reasons was the surge of imports, particularly from nations like South Korea, which itself prohibits American-made apparel from entering that country.

In your statement, you singled out the textile bill for criticism and opposition. In 1980 while a candidate for President, Ronald Reagan on at least two occasions made explicit written promises to the United States textile industry that, if elected, he would relate the growth of imports to the growth of the domestic market. As we know, that promise has not been kept.

I have two questions: Does your statement today mean that you believe President Reagan was wrong to make that promise? And second, if you would, address not me or the committee but the 1,000 families in Maine who have lost their jobs and tell them why you think the textile bill is such a bad thing.

Secretary **Baker**. Why I think the textile bill is a bad thing?

Senator **Mitchell**. Yes, correct.

Secretary **Baker**. I think the textile industry, as a whole, Senator, is doing better this year than it was last year when the textile legislation was passed and vetoed, in terms of earnings and that sort of thing. That doesn't mean that there are not plants still being closed.

The first part of your question was——

Senator **Mitchell**. Do you believe that President Reagan was wrong to make that promise?

Secretary **Baker**. No, I don't think he was. I think that it is the case, Senator, that Presidents are not always able to keep all of the promises they make. I would have to acknowledge that. I frankly think this President has done a pretty darned good job when compared to some of his predecessors in keeping some promises, such as the promise to bring down inflation, the promise to reduce interest rates, the promise to give us sustained economic growth without inflation, the promise to do something about rebuilding America's defenses, and so forth and so on.

Senator **Mitchell**. Well, if you don't feel that he was wrong to make a promise to relate the growth of the textile imports to the growth of the domestic market, why do you oppose the bill which seeks to do what the President promised to do in 1980?

Secretary **Baker**. One reason is that it was loaded up with protection for a whole lot of other industries. It would also have involved retaliation against other segments of this society and country that are very hard-hit, including agriculture. And we think that sector-specific protection like that is simply the wrong way to go.

Senator **Mitchell**. But that is what the President promised in 1980, and you said you don't think he was wrong to make that promise.

Secretary **Baker**. No, I don't. I don't think so.

Senator **Mitchell**. Then how can you oppose an effort to do now what he promised to do in 1980, and which you say he was not wrong to promise?

Secretary **Baker**. Well, because the bill goes farther, Senator. I happen to know from my——

Senator **Mitchell**. So, would you support a bill that did just that?

Secretary **Baker**. I happen to know from my period in the White House that we took steps in the first four years to try very hard to fulfill that promise. We put in some controls on imports, we adopted some additional restraints, but, you are quite right, they ended up not holding imports to the exact level of the growth in the domestic market. I quite agree with you.

Senator **Mitchell**. Not to the exact level.

First, I disagree with your characterization of the efforts by the Administration to adhere to that promise. I think the record is plainly to the contrary.

I would appreciate, in the limited time left, if you would address the 1,000 families in Maine and tell them what you have to offer them, what consolation they have from what you have said here today.

Secretary **Baker**. Well, what we have to offer them is a $1 billion program that is a part of our competitiveness package for adjustment assistance, Senator Mitchell, recognizing the hurt and the grief that dislocations like this cause.

Senator **Mitchell**. How do you propose to finance that?

Secretary **Baker**. It is going to be financed, as far as I know, out of general revenues. It is in the President's budget, though, and it is not going to be——

Senator **Mitchell**. We already have a deficit and no new revenues—right?—by the Administration, so——

Secretary **Baker**. Well, it is within the President's budget, which meets the Gramm-Rudman-Hollings targets and which he has sent up here.

Senator **Mitchell**. I am afraid I must say to you that if any of those 1,000 families are watching and listening to this, they have received very little consolation from your statement. It is a very discouraging view for those who are adversely affected by the policies that the Administration has pursued and the failure to honor the President's promises.

Thank you, Mr. Chairman.

The **Chairman**. Thank you very much.

Senator Daschle.

Senator **Daschle**. Thank you, Mr. Chairman.

I share the view of many who have already expressed themselves with regard to semantics here, and Senator Rockefeller was the most recent. But this whole notion of labeling everything you oppose as "protectionism" I think really does a disservice to the Committee and to a legitimate discussion of the parameters within which we must discuss many of these things.

You argue that the President needs flexibility, and I certainly share that view; but we could say that that is tantamount to "competitive surrender," as well, if we wanted to use the kind of semantic labeling we are talking about this morning. I think that is wrong.

I was surprised somewhat that you used the most recent agreement with the EEC as an example of how this flexibility, this opportunity for the President to use his discretion, works to our advantage.

The Executive President of the National Corngrowers, Michael Hall, when asked about that particular agreement, said, "That is simply not equitable, balanced compensation for the loss of corn exports to Spain." Well, that is really what happened. We have lost virtually 50 percent of our corn exports to Spain as a result of this agreement over what we have had over the last three years. Now, that to me is an untenable situation; and yet, we are claiming that as some kind of a victory. How do you use that particular example as one which justifies your cause for more flexibility?

Secretary **Baker**. Senator Daschle, if we hadn't achieved that settlement, if we hadn't been able to negotiate that agreement, the loss to the corngrowers would have been a great deal more than it was.

Senator **Daschle**. So what you are saying is, because the EEC and in particular Spain and Portugal were able to use mandatory restrictions on imports into their country, we have talked them out of using those mandatory restrictions but in the process have had to give up one-half of our exports to those countries. How do we claim victory in all of that?

Secretary **Baker**. We have gotten compensation from them. If one-half is the figure, and I don't have that kind of detail but Ambassador Yeutter will, then we have gotten one-half that we wouldn't have gotten otherwise, plus we have gotten compensation in other sectors, and those other sectors are important to resolving the problem that Senator Riegle brings before us today, those charts. You cannot look at this just on a sector-by-sector basis, you really can't.

Senator Daschle. Well, I don't think anyone is expecting that we would look at it on a sector-by-sector basis, although I think Senator Mitchell has a good point when he talks about taking individual sectors and from that developing a composite. When we look at textiles, when we look at agriculture, when we look at the broad range of sectors, one is hard-pressed. As Senator Rockefeller has said, one can even look at semiconductors. There aren't many sectors within which we can look at great pride and some satisfaction that this new toughness over the last couple of years has really progressed to a point where we can look with some satisfaction that we are now on the right track.

Frankly, one-half of nothing is nothing. And we really had nothing when we went into those negotiations, and we came out with virtually nothing if we've got a trade deficit with the countries that we're dealing with, and that was the situation with the EEC.

Secretary Baker. I don't understand you when you say you had nothing going in. I don't understand. I thought you were concerned that they had taken action against our corn sales to Portugal and Spain. I think we did have something.

Senator Daschle. Well, it seems to me we got bamboozled, Mr. Baker. I am troubled by this notion that we could go in and expect a half a loaf and claim victory when, if all we can expect out of this new toughness is half loaves every time we walk into it, half loaves from what we had before, that red——

Secretary Baker. We got a half loaf——

Senator Daschle. If you will let me finish—that red line is going to get bigger and bigger.

Now let me just go to a second point.

Secretary Baker. Well, let me answer your question, if I might. You have got a half-loaf, yes, as far as agriculture is concerned, Senator; we got a whole loaf as far as industry and agriculture combined in this country are concerned. In terms of the total dollar volume of compensation, we got a whole loaf. You can pursue it further, I suppose, with Ambassador Yeutter who negotiated it, but I think it was a very good agreement.

Senator Daschle. That is arguable.

In the remaining time I have, let me ask you another question. Let us assume that you do have a new toughness and that we can expect that that is going to result in some real change in the figures that Senator Riegle has just outlined in his chart. What confidence does the committee have that, after this Administration leaves, we can expect the same continuity from a new Administration, Republican or Democrat, if we don't mandate in the law that certain things are accomplished? We may have someone who brings a completely new perspective to the White House in the next generation. And if that happens, are we not in the same position?

Arguing that the new toughness is important I think is relevant here, but I think we have to look beyond that Administration, and from your comments I really don't see any cause for confidence that we can expect long-term continuity with the trade position in this country.

Secretary BAKER. Well, I think my answer to Senator Danforth is the answer I would give you to that question, and that is simply that no Administration is going to acquiesce in a $150-170 billion—depending on which basis you look at—trade deficit. Politically and economically, that is simply unsustainable. It is unsustainable for the Congress, and it is unsustainable for the Administration. And I think that is the assurance that you have, the same thing that has prompted us to act over the past two years.

Senator DASCHLE. But if that is the motivation—let us assume we have a balance of trade that is perhaps even a favorable balance, in two or three years—if we do nothing, and if we wait until the trade deficit is our only incentive, we will be right back to where we are today six years from now with that kind of assurance.

Secretary BAKER. We would be if we did nothing, but we are sending you 1600 pages of legislative requests up here today, and I would hope that you would take a close look at them, because if we passed that program we would be doing a lot more, if I may say so, Senator, than simply mandating retaliation sector by sector or country by country.

Senator DASCHLE. Thank you, Mr. Chairman.

The CHAIRMAN. Gentlemen, we have to move on.

Senator Chafee.

Senator CHAFEE. Thank you, Mr. Chairman.

Mr. Secretary, first I want to commend you for what you are doing, and we look forward to the legislation you are sending up. Some of it deals with matters we have struggled with before, and others are new initiatives.

The Foreign Corrupt Practices is something I have been involved with. As you know, it has passed the Senate a couple of times, and I hope you will continue to give us an assist on that.

Perhaps you saw the statement of Bob Strauss who appeared before this Committee, who you know has great standing here, as regards the elimination of the President's discretion. He felt that the Congress should force him to take compulsory actions but not mandatory actions. In other words, he concluded that there ought to be a little running room for the President.

Let me just say this, Mr. Secretary: We have a lot of confrontation coming up in this Congress, if I can judge from the newspaper article dealing with the appearance of the Democratic leaders in Bal Harbor, Florida, where there was cheering as the leaders there said, "Any bill that passes that the President doesn't veto isn't worth passing." And commenting on Senator Bentsen's bill that had 55 Senate sponsors, it said, "Senator Bentsen's bill is an empty box." I couldn't quite understand Senator Byrd's position on all of this, but he did say——

The CHAIRMAN. Am I going to have equal time on that? [Laughter.]

Senator CHAFEE. No, I signed your bill; I'm for it. I am just reading from the newspaper article in Bal Harbor.

And Senator Byrd said the final bill will be "much like the Gephart Bill, but not quite." Well, I don't know about that, let's see. I hope that this Committee can be more responsible than that bill that came out of the House last year, and I am confident that we will be.

I just want to ask you this, though: I share the concern that has been voiced here about the inability for us to gain access, whether it is for banks or insurance companies or other activities such as that, in take Japan for example. What do we do? Here we are, we are providing a market for these other nations of vast proportions, and it does seem that we are not able to retaliate successfully.

Let us just take the banking business, for example. What do we do?

Secretary **Baker**. Senator Chafee, thank you for pointing out that cooperation is a two-way street. But what we do is, we use the threat of retaliation to gain access, just as we have for access to the Tokyo Stock Exchange, just as we have for access by some commercial banks in Japan. In the case of the acquisition by Sumitomo of an interest in Goldman-Sachs, it was interesting to note, I think, that Japan opened some of their financial services sector to us before that acquisition was approved. And it is the threat of retaliation that is important, so that you have the flexibility to use it toward those ends.

We don't have access to the degree or extent that you or I would like, but we are making very significant progress.

Senator **Chafee**. Well, I have great reservations, as you know, in compulsory retaliation and depriving the President of discretion in how to use his power. I share your views, I share those of Mr. Strauss.

However, what do we do? Let's just take the specific case of the airport that is being constructed off Yokohama. Now, all of our engineering companies, heavy manufacturing equipment companies have registered complaints about not being able to get part of that construction project.

Secretary **Baker**. Senator, the reason I was checking here with staff is because I wasn't sure whether there had been any developments over the last couple of days. As you know, we are working that problem very, very aggressively. We have had people over there extensively. We think it would be extremely unfortunate if we were denied the opportunity to bid on that project, if our construction companies were not given the opportunity.

The issue has been surfaced with the government of Japan at the very top level.

Senator **Chafee**. Any prediction on the outcome?

Secretary **Baker**. I am not prepared to predict here today, because I am sorry to say that the last report I had had on that was about a week or so ago.

Senator **Chafee**. Well, I encourage you to pursue the activities that you have been, because this is going to be a tough row to hoe up here. It is going to be tough to get a good trade bill. I hope we can, and we count on you for all the efforts you can lend to the cause. Thank you.

Thank you, Mr. Chairman.

The **Chairman**. Senator Wallop?

Senator **Wallop**. Thank you, Mr. Chairman.

Secretary Baker, I welcome the Administration's initiative. I think it is long overdue that we have stopped looking at this problem so simplistically, as the Gephart Bill and indeed the Senate's bill would tend to indicate, that it is just a matter of a couple of relations with a couple of countries and that nobody else in the world's economics relates to the other's.

Just for example, Korea has only been in the trade surplus situation for about two and a half years. It has an enormous foreign debt. I would ask anyone on this committee or anybody in the Administration how are they going to repay their debt without a surplus? I would ask them also to contemplate who they owe that debt principally to, which is American banks. How are we going to change the balance of trade if they are unable to repay those?

That brings me to the point of Senator Riegle's charts over there. The principal reason—not the sole reason, but the principal reason—that the U.S. is a debtor nation now is because we are no longer making bad loans to Third World countries; capital is being retained here, not exported out.

I don't know how it helps us to be a creditor nation with people who can't repay their debt. I mean, somehow or another, that is a piece of economics that is lost on me.

I worry that the Senate's bill in general and the House bill in particular defines this new word competition "competitive," and creates a competitive circumstance by eliminating competition. I don't see where that actually gains us markets overseas, which clearly has to be part of trade. Trade is not only purchases but sales, and if we protect ourselves to the point where nothing we make here can be sold on any market in the world because it all has a cocoon around it, it seems to me that those figures get worse, not better.

So I am hoping that, as the Administration's bill comes up here, we do look at some of the other circumstances, including some of the tax bill, which I think, however inadvertently, makes it more difficult for America to maintain a presence overseas by the treatment of overseas income not of corporations but of individuals.

Is part of the Administration's bill a look at how it is possible for corporations to have a presence overseas, to move those products that we now have coming into play because of the change in the value of the dollar? Somebody has to represent and present those to our overseas trading partners. Is part of the Administration's proposal any change in the structure or treatment of overseas income?

Secretary **Baker**. Senator, let me first say that I think I agree with everything you just said, and particularly the point which you made—which I made, I think, before you came into the room—that that red portion of the chart that Senator Riegle displayed is going to get a whole lot bigger if we foreclose competition by adopting a bill that turned out to be protectionist.

The Administration would like to see us depart from the practice we have followed in the past of not addressing, for instance, Senator, the R&D tax credit until just before it expires so that we give businesses and industries an opportunity to plan.

Senator **Wallop**. That gives me a certain celebrative feeling. [Laughter.]

Having sort of run that thing now for seven years, it is nice to know that it is policy.

Secretary **Baker**. The Administration thinks that we need to deal finally with the issue of the allocation of R&D between domestic and foreign operations under Section 861. As you know, there is a deadline on us to do that by the 7th of August. We intend to do it, and we intend to resolve differences in favor of letting United States businesses become more competitive, by letting them allocate more in the direction that foreign companies are allowed to allocate when they have operations in both countries. I hope that addresses your question.

Senator **Wallop**. Well, yes, but that is only part of it. I am talking about the tax structure on overseas personal income that was contained in the Tax Reform Bill. It makes it extremely difficult for anybody to maintain a living overseas.

Secretary **Baker**. Well, do you mean the reduction of the exclusion from $80,000 to $70,000? We have no plans to revisit that, Senator, because we think that the rate reductions that were given to those individuals make up for the——

Senator **Wallop**. But they don't, because the rate reduction was quadruply eliminated by the change in the value of the dollar. And if we are going to have a large business presence overseas, we are going to have to make it possible for a large personnel involvement overseas. And everything in the tax bill runs upstream from that concept, especially in light of the devaluation of the dollar.

Secretary **Baker**. I think the two things are separate. I understand how they are related in the effect on the person working overseas. I think it would be unfortunate if we opened up the Tax Reform Bill to deal with that specific situation, Senator, because I think at the time tax reform was passed, the reduction in the exemption or the exclusion was made up for or at least partially made up for by the decrease in the rate, the marginal rates that were afforded to all Americans.

If there is a problem as a consequence of the dollar becoming so much weaker, there is a problem with respect to Americans residing abroad, maybe that is something we ought to take a look at. But that is a separate issue, in my view, from reopening the Tax Reform Bill.

Senator **Wallop**. However we get into the book is all right by me, as long as we open the page.

The **Chairman**. Senator Bradley?

Senator **Bradley**. Thank you very much, Mr. Chairman.

Mr. Secretary, it is good to see you. I think that my point is we are at our maximum point of leverage with regard to the Japanese and the Germans and other people, given the decline of the dollar. I think that there is a certain threat with Congress threatening protectionist legislation or the Administration threatening some form of retaliation, but it works much better when Mr. Toyota and the head of Siemann's and the head of Host call the Finance Minister and say, "You know, we can't live with the increase in prices in the American market because of the depreciation of our currency vis-a-vis another; therefore, do what the Americans are asking." And I would like to get from you a kind of catalogue of things that you are asking the Japanese and the Germans to do, particularly given and including the G–5 meeting this weekend.

So my questions to you are several. One is: What fiscal deficits do you think Japan and Germany should plan the next couple of years?

Secretary **Baker**. Do you mean as a percentage of GNP?

Senator **Bradley**. Their fiscal deficits.

Secretary **Baker**. Senator, if it is all right, I would really prefer not to answer questions about what we might or might not be seeking to negotiate in a multilateral meeting, in a public session of the Committee.

I would answer your question by saying it is no secret that we have been seeking stimulative measures on the part of surplus countries to help us resolve the external imbalances that exist today.

Senator **Bradley**. Okay. In Japan, then. Is the stimulative effect of the tax cut, the individual tax cut, going to be offset by a massive new consumption tax?

Secretary **Baker**. It is hard to say, Senator. And again, I would prefer not to comment publicly on what our view is or is not of the consumption tax. As you know, we favorably view the initial element of that tax.

Senator **Bradley**. You agree that it is pretty hard to get a stimulative tax proposal if on the one hand you cut individual rates and on the other hand you put a big consumption tax in? I don't want to argue that point with you, but just leave it.

You also don't want to offer your opinion about unemployment in Germany the next couple of years? What do you think the reason for that would be?

Secretary **Baker**. Let me offer my opinion on all of this by saying to you that it has always been our position that efforts to stabilize currencies succeed when they are supported by domestic policies that promote more balanced growth among all nations. It is no secret that we have been seeking measures from those countries that would permit them to stimulate domestic demand.

I said before you got in here that somebody else has accused us of being too soft in this area, and I said before you got in here that some have accused us of being too tough, in terms of our approach to the dollar.

Senator **Bradley**. Well, my only point is, do you expect that you have a lot of groundwork to do before the next economic summit? This G–5 meeting is going to deal only with the dollar, and the question is: What do you see needs to be done in the way of groundwork between now and the summer?

Secretary **Baker**. Again, I don't want to get into commenting publicly about what I expect or don't expect from this forthcoming meeting, Senator Bradley. Normally we don't even comment on the fact of a G–5 or a G–7 meeting being held; but the fact of the matter is that, because the Diet is in session in Japan, the Minister can't leave the country without making a public announcement that he is going out of the country to have a meeting, so we have to depart from our normal procedure, and I really don't want to get into what we expect or don't expect.

Senator **Bradley**. Let me just try one more. This isn't directly related to these meetings, but I think it is a concern that all of us have, particularly given the awareness of the size of the external debt. And my question to you relates to Japan.

The Administration has been instrumental in getting Japan to open up their capital markets, getting Japan to export more. As you know, the total savings in the Postal Savings System are about $600 billion, and last year they opened it up til about $12 billion of that now flows into the international capital markets and seeks the highest rate of return.

My question to you is: In the years to come, when there is a real probability—if you look at the amount of capital that flows out, say, in the insurance sector—of another $80–90 billion of Japanese savings coming into the world market seeking the highest rate of return, where would you like to see this capital go? And what are you doing to ensure that it goes where you would like to see it?

Secretary **Baker**. All right. Before I answer that, may I say one final thing with respect to this business of a G-5/G-7 meeting? I would like to knock down the suggestions that have appeared to the effect that somehow this is an emergency meeting—it is not. We frequently and normally meet, have a midwinter meeting of the G-5.

Where do we want to see that surplus go? Obviously we know that a lot of it comes into this country, and to some extent it finances our deficit, and that is not a matter that—we have seen no discernible effect, let me say this, as far as the decline of the dollar is concerned, on our ability to finance that deficit or the price we pay or anything else.

Some of that capital, surplus, is going to continue to come in here because of the political stability that is afforded by this country, in my view. We would like to see a lot of that surplus recycled into the Third World, if possible. We would like to see it done in a multilateral context. We would like to see it not done by way of tying it to trade. We obviously want to see the elimination of tied-aid credits, but we would like to see more of that Japanese surplus go into multilateral institutions.

What are we doing to accomplish that? We gave up some shares in the World Bank this year in order to give Japan some additional shares, so that they could increase their contribution to IDA by an additional $450–500 million.

They have indicated a willingness to lend some money to the International Monetary Fund. They are receiving favorably discussions and suggestions that they somehow find a way to recycle some of that surplus into the lesser-developed countries of the world, to help us with the debt problem among other things.

Senator **Bradley**. Thank you.

The **Chairman**. Thank you very much, gentlemen.

We will have a second round of questioning, but I would urge that you keep your statements short, if you will. We have Ambassador Yeutter waiting to testify, and I know that the Secretary has other obligations.

But let me state, Mr. Secretary, what we are seeking here with the Administration is cooperation and not confrontation, and sometimes some of the rhetoric gets in the way.

I had a study made last year by the Congressional Research Service, and that study showed that, with respect to every major piece of trade legislation offered by a Senator, Republican or Democrat, the Administration labeled it "protectionist."

Now, I have heard you state here that this Administration has given more import relief than any Administration in 30 years. On the other hand, I heard a prominent economist the other day said this was the most protectionist Administration since Herbert Hoover. I am wondering what the difference is in the terminology and the rhetoric in that kind of a situation.

I have looked at a Georgetown University study that says, of $360 billion worth of imports in 1986, 22 percent were covered by some form of special import protection. In 1980 it was 12 percent. So, it has gone from 12 to 22 percent.

If we are going to have that kind of confrontation, I get concerned. When the Administration moved, it's "import relief." When the Congress calls for something like that, it becomes "protectionism." That kind of rhetoric doesn't help when you are trying to bring about cooperation.

Secretary BAKER. Well, Mr. Chairman, let me hasten to assure you that that has not been my purpose here this morning. Import relief is protectionism, whether we do it or whether it comes about through some other approach. But we should be extremely careful not to enlarge upon that if we can avoid it, because at some point you step over the line and you trigger an all-out trade war.

Once this greatest market in the world becomes protectionist, then we are going to see the likelihood of others reacting to that, closing down markets abroad, and we will have, in my view, as I said before, the same kind of situation we had in the late Thirties.

But I am not suggesting for one minute that the import relief we have granted isn't protectionist—it is. But we ought to hold all of that to a minimum and keep it down, and it ought not to be mandated that we do it under certain circumstances.

I have said to people, and I know you know this, and I will say it again: I think that your bill is one that we can certainly work with cooperatively, and find, hopefully, a common basis for the trade law changes that would be the ultimate vehicle that comes out of it. I would worry some about controlling the Senate floor, as you and I have discussed. And it is important that we work together so we can do that.

The CHAIRMAN. Mr. Secretary, I am not sure that anybody can do that. [Laughter.]

Secretary BAKER. And I know that you, in good faith, want to find a way to do that, and let me just assure you that the Administration does, so that the ultimate product that comes out of here is not more protection.

The CHAIRMAN. Thank you.

Following my own admonition on time, I will now yield to Senator Roth.

Senator ROTH. Mr. Secretary, in your opening statement you made reference to the increased activity in the area of research, particularly at our universities and elsewhere. It is a matter that I warmly applaud.

I think most people agree that one of the great advantages this nation has is its technology, that we create many new ideas.

But one of my concerns—I am not sure what the answer is but I would like to have your comment—is that, as we spend more in cooperation with universities, perhaps cooperative with industry as well, other countries have also understood that these are areas of many new ideas and are likewise investing in these university research programs.

My question is: Has the Administration given any thought particularly as to whether or not we have equal access in these other countries to their research? And to what extent may this represent a problem, if we are giving them as rapid access to our technology through universities as we have ourselves?

Secretary **Baker**. Well, Senator, I do think it is a problem, and it is one that has been concerned. One of the major elements of the President's program is the protection of intellectual property rights, and we seek greater protection for our property rights abroad, for our intellectual property rights abroad, and we seek it through bilateral and multilateral negotiations.

But I still think it is important that we find a way, make it easier, to share much of the R&D that is done in this country through the Defense Department, make it easier to share that with the United States private sector, so that we can take advantage of that research and development. But you are quite right: we have to do it in a way that doesn't make it just a one-way street.

Senator **Roth**. Because while Japan protects much of that technology, know-how is of course not protected, and there is a significant difference.

Secretary **Baker**. That is correct.

Senator **Roth**. I think this is a problem that deserves careful attention. As I say, I am not sure what the answer is.

Secretary **Baker**. We are asking for some reforms, for instance of the Freedom of Information Act, to protect business confidentiality; we are asking that we enhance copyright protection in the manner suggested by the Bern Convention; we are suggesting a number of legislative changes in our patent laws that will enhance the protection of intellectual property.

Senator **Roth**. Mr. Chairman, I have other questions, but I will submit them in writing.

The **Chairman**. We will accept questions in writing to be addressed to the Secretary from all of the members.

Senator Baucus?

Senator **Baucus**. Thank you, Mr. Chairman.

Mr. Secretary, there is a growing feeling I think in this country that the United States has for too long gone it alone in providing national security for Western allies—that is, a large percent of our GNP is spent on national defense; it is somewhere around 6–6.5 percent. Japan has increased its share to 1.1 percent, Canada is about 2–3 percent and Western Europe about 2–3 percent.

The feeling is that, whereas we could afford to provide that national security umbrella in the past, we can not afford to do quite as much now; we have to have more resources diverted to say education, to R&D, civilian R&D, and to other domestic components of the American economy, the argument being that American national security depends not only on American military security but also on American economic security, that we as a country can only project force overseas and power overseas if we are economically sound; and further pointing out that, yes, there is some R&D spinoff from military R&D, but how many nuclear dishwashers do we want in this country?

There is an interesting statistic here. If you look at the total R&D effort of the United States, Japan, and Western Germany, all three countries totally, private and public, spend about 2.6 percent of their GNP on R&D—about 2.6 percent for all countries. The difference, however, is that our R&D is about 75 percent civilian and 25 percent military, but in those other two countries all of it, for all practical purposes, is civilian and very little of it is military.

I am wondering how far the Administration thinks the world should go—that is, the United States and its major trading partners, the Western Free World trading partners—in trying to share the burden? That is, to encourage those countries to devote a larger share of their GNP in not only defense spending but foreign aid, so that Americans are not carrying so much of their freight? To what degree do you think the Administration should go to encourage those countries to start paying more of their freight?

Secretary BAKER. Well, in answer to Senator Bradley, I just talked about what we think some of these surplus countries should do with respect to LDC debt problems and things like that, in terms of greater participation in multilateral fora.

Let me say, Senator Baucus, I totally agree with you, you can't be strong defensively unless you are strong economically; there is absolutely no question about that.

I must say that the expenditures that we are talking about, though, the national security community in this country would tell you are expenditures for the defense of America; they are not expenditures for the defense of some other country. Where other countries have a concurrent defense interest, we strongly urge them, continually, to bear their fair share of the burden. And while there is clearly room for improvement in the overall performance, I suppose, of our allies, a number of them are making substantial contributions; and you mentioned one, the piercing of the 1-percent limit by Japan, the 60 percent of NATO's active and reserve manpower which is contributed by other NATO members, and there are others.

So, it is a question of balancing the considerations. The argument that these defense expenditures are for the benefit of other countries is not an argument that is accepted, if I may say so, by the national security community in this country; these expenditures are for the defense of America.

I do think we should look to these surplus countries for greater participation and greater help in dealing with the problems of lesser developed countries, as I indicated in my answer to Senator Bradley.

Senator BAUCUS. I just think we can go quite a bit further, frankly, if you add in both defense expenditures and foreign aid contributions. Japan has grown up now. They are a big power, the largest creditor nation in the world. It seems to me that they can do more. And I think the Administration should be much more aggressive in encouraging that, pushing that thought.

Secretary BAKER. Well, they have abandoned the 1-percent cap.

Senator BAUCUS. To 1.1—big deal.

Secretary BAKER. Well, but if they are going to go further, at some point there will be a very strong and healthy debate on whether or not we really want to see Japan——

Senator BAUCUS. It doesn't only have to be military; it can be foreign aid, and there are lots of other contributions.

Secretary BAKER. Well, I will address the foreign aid one: Absolutely, we agree with that.

The CHAIRMAN. Gentlemen, once again, we have Ambassador Yeutter waiting. If you will, please limit your questioning in this last round.

Senator Riegle?

Senator RIEGLE. Thank you, Mr. Chairman.

Mr. Secretary, as I look at the latest data on the trade surpluses that the nations of Japan, Taiwan, and Korea have with us, the figures that the Department of Commerce has generated indicate that the Japanese last year had a trade surplus with the United States of $59 billion; Korea, $7 billion; Taiwan, $16 billion. That adds up roughly to $82 billion, and that gets very close to half of our total trade deficit of last year, just with those three countries. Now, they are all different, but I think there is a pattern here, and the pattern is that Japan has sort of set the example which is now being followed by Korea and Taiwan, and they are running up and maintaining these enormous bilateral surpluses from us. It has two effects: it drains us of capital, which that chart that I was showing before indicates, as we go further in this debtor-nation status; but obviously we are losing jobs all across the country—we are losing them in Silicon Valley, we are losing them in Michigan, and as Senator Mitchell says we are losing them in Maine. I don't know a state of the 50 States that isn't affected by this trade disaster that we have on our hands at the moment.

My question is this: In terms of bilateral negotiations, it seems to me that every time the President goes in to meet with Nakasone, he goes in fully clothed and, in a sense, comes out in his undershorts, because we just don't make any progress with the Japanese. The bottom line after all of the talking and the patting on the back, and this and that the deficit with Japan just keeps getting bigger. And it got bigger last year, despite the fall in the value of the dollar.

Do we have a specific plan? And I would like you to address all three countries. How much is the deficit with Taiwan going to come down in 1987? Do we have a target? And if so, what is the target, and how are we going to bring it down? Do we have a discrete goal? Are we going to bring that deficit down from $16 billion to $15 billion, or $14 billion, or $12 billion, or $10 billion? And the same thing with Korea and the $7-billion surplus they have with us; are we going to bring that down in the next 12 months by a billion dollars or a billion and a half dollars? And if we don't have those goals, especially with nations where you have got this persistent enormous bilateral problem, I am frank to say I don't see how you are going to have any confidence that we are going to get improvement unless you set a discrete target and that you have a plausible strategy for getting there. Because, otherwise, it seems to me you are going to go through this same rain dance that goes on in all of these meetings, where everybody makes promises, and then we get the bottom line at the end of the year and the bottom line is worse.

So, what are your goals? Can you tell me how much we are going to knock that deficit down with Taiwan over the next 12 months?

Secretary BAKER. If I might, Senator Riegle, let me say that I really disagree with you that we go through this Kabuki dance and don't get anywhere; we have made a lot of progress in my view. You mentioned this in your very kind opening comment about the dollar-yen relationship. I mentioned it in answer to an earlier question about the 301 cases we have filed successfully against Japan, and Ambassador Yeutter can elaborate on that. Senator Chafee mentioned it with respect to the opening of their capital markets and financial markets.

You are quite right, this capital does come in here and finances that deficit, but it also finances, if I may say so, our fiscal deficit; and I don't think we want to suggest right now, at least, that we want to somehow shut off some of that Japanese capital coming in.

We do not have a persistent trade deficit with Korea. As Senator Wallop pointed out, Korea has been in surplus with us for two years; they are a big debtor nation. They will never get even with the box, if you will, and be able to pay their debts if they are not permitted to generate some trade surplus.

The answer is, we do not have country-specific numbers. But the further answer is: We are dealing particularly with the Japanese surplus in a very comprehensive overall way, across the board, continuously, in all sorts of different fora and forums, at the technical staff level in this government, at the policymaking level, in multilateral meetings of the G-5, G-7, and the Summit. So, the objective there is to get that deficit down.

I think we might make a mistake, quite frankly, if we set a specific number for ourselves and limit ourselves to that.

Senator RIEGLE. Let me just say this: With respect to Korea, the data that we have from the Department of Commerce shows that they have had a surplus with the United States for the last six years, and it is getting larger. It was $7.1 billion last year.

But let me just ask you this, because I think we need to have this on the record: If you don't have a discrete goal that you are setting, what can we anticipate? What do you think is reasonable for us to expect? Is the deficit with Taiwan, for example, in the next 12 months going to go down?

Secretary BAKER. It should go down, as a consequence of some of the changes that we are beginning to get in the exchange rate relationship.

Senator RIEGLE. Do you expect it to go down?

Secretary BAKER. I do expect the Japanese deficit to go down.

The two years, by the way, that I talked about in Korea is their overall surplus internationally, not just with the United States. You are quite right.

The CHAIRMAN. Thank you, gentlemen.

Senator Bradley?

Senator BRADLEY. Thank you very much, Mr. Chairman.

Mr. Secretary, I know you couldn't answer the questions earlier on the upcoming G-5 meeting, but I hope you will tell the other ministers who are there from around the world that, when you talk about stimulative measures, that you have a Senate who is interested, not just in interest rates but is also interested in tax policy in those countries, also interested in housing investment and how it is going to get started in places like Japan, also interested in what level they are willing to tolerate. And we are going to ask you afterwards what you said about those things. I understand how you cannot do it before.

A second point: We have agreement on the issue of Third World debt to the extent that we both believe that growth is the only way that we are going to get out from under this burden; and second, that we also believe in a case-by-ease approach, no across-the-board approach but country-by-country.

I am also pleased to see in the Mexican Agreement that you provided interest rate relief. I think that was an important step.

Secretary **Baker**. We didn't provide it.

Senator **Bradley**. Well, the banks did. And I was pleased to know of your role in getting the banks to provide interest rate relief.

Secretary **Baker**. I had no role at all, Senator, in that.

Senator **Bradley**. Mr. Volcker did, then. I assume they didn't wake up one morning and say, "You know, I want to provide below-market interest rates." But, however, "Let us invoke whatever means is out there to produce the result."

Secretary **Baker**. I am happy to be able to report to you that I had no conversation with any banker about that, none.

Senator **Bradley**. Okay. We can always have designees have the conversations; I understand. [Laughter.]

Secretary **Baker**. The Federal Reserve is totally independent on this. [Laughter.]

Senator **Bradley**. Well, we have a little disagreement on debt relief, per se, as opposed to emergency new loans as a means of dealing with this problem.

Secretary **Baker**. Right.

Senator **Bradley**. And they even deal with the systemic approach or deal with broad economic issues that affect all countries. What I would like to do is see if I can't get agreement on some principles:

Would you agree that the major burden falls, and should fall, on the backs of the LDC political leaders themselves?

Secretary **Baker**. Yes, sir.

Senator **Bradley**. Would you agree that the first step, really, towards stable economic growth should be a stable democratic political system?

Secretary **Baker**. Absolutely.

Senator **Bradley**. Would you agree, in the case of the Philippines, that Corey Aquino has made major strides toward stabilizing Philippine democracy?

Secretary **Baker**. Yes, she has. Let me qualify my answer by saying just this. You have got an example, for instance, in Chile, where you don't have democratic institutions and traditions, but you have got a pretty darned good economic performance.

Senator **Bradley**. But you certainly don't disagree with the argument that we want stable democracies as a step——

Secretary **Baker**. That is correct.

Senator **Bradley**. Okay. And you agree that Corey Aquino has made major strides?

Secretary **BAKER**. Yes, sir.

Senator **BRADLEY**. Would you agree that any disruption in the Philippine debt management basically undercuts your own concept of self-help which we talked about, in encouraging reforms in debtor countries?

Secretary **BAKER**. Generally speaking, yes. I don't know what you mean by "disruption."

Senator **BRADLEY**. I will get to that in the next point.

Secretary **BAKER**. That is why I qualified that answer. [Laughter.]

Senator **BRADLEY**. And so my last question to you, in regard to the Philippines, is: Do you think that the recent breakdown in negotiations between the Philippines and the banks is really healthy? Do you think it is promoting democracy? Do you think it is promoting economic growth?

Secretary **BAKER**. I don't think it is ever healthy, Senator Bradley, when there is a breakdown in negotiations between the debtor countries and their creditors.

Senator **BRADLEY**. Do you think that the creditor who walked, because all the Philippines wanted to do was to get the same deal that Mexico got, is really promoting the kind of framework that you would like to see for economic growth and democracy worldwide?

Secretary **BAKER**. Well, I think that question makes some assumptions that are not necessarily justified, Senator. To answer that No would mean that I subscribe somehow to the idea that the spreads over LIBOR should never exceed those of the Mexican package. I do not necessarily agree with that, because many countries are at levels considerably above the level that Mexico was at when it came down, when its creditors gave it a deal at thirteen-sixteenths. So——

Senator **BRADLEY**. Well now, if you take that to the next level and say should there be any interest rate relief whatsoever, and you see that it was provided to Mexico but it is not provided to the Philippines right now, and then you turn to a country like Brazil, and you see that Brazil has made real progress over the last four years, and yet there hasn't been a whole lot of voluntary new lending to Brazil, and it seems unlikely that it is going to be resumed in the future, my question to you is: What role is the Administration going to play in the Brazilian debt negotiations? Can we expect the same deal for Brazil that we got for Mexico?

Secretary **BAKER**. Well, the Administration will play the same role that it has been playing in these debt negotiations over the course of the past three or four years. Basically our view, Senator Bradley, is that we should not seek to mandate the commercial agreement between the banks and the countries, that we should do everything we can to encourage them to negotiate. Governments should not in any way mandate debt relief or seek, frankly, to require it; but they should do everything they can to try to bring the parties together.

Now, you cannot automatically compare——

Senator **BRADLEY**. But do you oppose——

The **CHAIRMAN**. Gentlemen, I will have to ask you to summarize.

Secretary **Baker**. Yes. You really shouldn't compare, necessarily, those two countries, where one of them is and was paying a much higher level of spread over LIBOR when the negotiations commenced. You can have every bit as much of a reduction in the spread without coming down to the percentage level that the other package was negotiated at.

The **Chairman**. Gentlemen, the time has expired. We have had two rounds of questioning, and we could obviously have had six, with the intense interest in the subject and your responsibility in it, Mr. Secretary.

We have appreciated very much your attendance here this morning and the comments that you have made. We will bring this part of the hearings to a close and look forward to hearing from Ambassador Yeutter, who has been most patient.

I hope you will not be as patient with our competitors as you have been with us. [Laughter.]

The **Chairman**. We are very pleased to have you here, and we will just let you proceed with your statement.

STATEMENT OF HON. CLAYTON YEUTTER, U.S. TRADE REPRESENTATIVE, WASHINGTON, DC

Ambassador **Yeutter**. Well, thank you. Mr. Chairman, it is very much of a pleasure to be here. You have had over two hours of testimony already this morning and a lot of it in the trade front, so I will make my comments very short in the interest of time.

I would say, first of all, Mr. Chairman, that I am very pleased to have an opportunity to comment on the trade elements of our overall competitiveness and trade package. As you can tell by Secretary Baker's testimony, he has the lead responsibility for that overall package, all 1,600 pages that will come up later today. I will have responsibility for the trade portion of that package, which will be about 160 pages, or thereabouts, but those are pretty important pages, and they are certainly of interest to everybody on this Committee. I hope we can devote considerable time and attention to those in the coming weeks.

I know your intent this morning, Mr. Chairman, is not to get involved in the details of trade legislation. This hearing was to get a look at the bigger picture. But in time, certainly, we will have a chance to discuss your proposed legislation as well as ours, and I hope that between the Committee and ourselves we can put together a work product that would be in the interest of all Americans and one which people on both sides of the political aisle could support with enthusiasm.

As to the trade picture itself, the legislative elements thereof, I would start, Mr. Chairman, by saying that I am convinced that legislation is in order in 1987, not because we are going to solve a $170 billion trade deficit through legislation—we are not—and nobody in the Congress or the Administration or the general public ought to deceive themselves on that point. The answers to a $170-billion trade deficit lie other than on the legislative front. But we can do some constructive things legislatively, and I hope that we do precisely that.

When I first looked at the legislative scene shortly after I returned to government about 20 months ago now, I didn't feel there was much that could be achieved legislatively that would be helpful or constructive. After all, we had a major legislative package in this area back in 1974, and that package has served the country very well in the intervening 12 years. It is still a very solid, sensible piece of legislation, and the country has used it effectively in the intervening period. So, I don't think we need major changes to the 1974 Trade Act, but we can use some.

Mr. Chairman, the package that we have has grown over the last 20 months, and what will be coming over this afternoon reflects everything we have accumulated during that period that can be done in a constructive and positive vein. And we will articulate all of that at the right time.

So I hope what we can do, Mr. Chairman, in the next several weeks is to concentrate on developing some legislation that will be positive and constructive and that will improve the environment in which we handle trade issues nationally and internationally, and I am convinced that is a possibility. We should not stray beyond that to trying to correct problems that are simply not correctable through the legislative process. And, as Secretary Baker indicated earlier, we certainly should not stray down a protectionist road which will come back to haunt this country in future years.

That is enough as a beginning statement, Mr. Chairman. I would be happy to entertain any questions you might have. My full statement, of course, is available for the record.

[The prepared testimony of Ambassador Yeutter follows:]

TESTIMONY OF
AMBASSADOR CLAYTON YEUTTER
UNITED STATES TRADE REPRESENTATIVE

BEFORE THE

COMMITTEE ON FINANCE
U.S. SENATE

FEBRUARY 19, 1987

Mr. Chairman and members of the Committee, I am pleased to appear before you today and want to commend all of you for the bipartisan cooperation you have demonstrated in your efforts thus far to craft responsible, effective trade legislation.

We in the Administration look forward to working with you throughout that process. Our bill is being transmitted to the Congress today. In developing that bill, we were guided by several overarching considerations. For example, we considered whether each proposal would:

- facilitate the competitiveness of U.S. industry,
- conform to our international obligations, and
- enhance our leverage in the Uruguay Round and in other international trade negotiations.

We also asked if each proposal would:

- provoke costly retaliation against U.S. exports, or
- invite our trading partners to enact mirror legislation, to the detriment of U.S. exports.

These are the same tests we will apply in considering proposals emanating from the Congress. Some provisions in S. 490, the Omnibus Trade Act of 1987, meet the tests outlined above; others do not. I look forward to testifying at a later occasion on the details of the Administration's bill and the Senate proposals before the Committee.

Let us turn now to one of our most challenging national problems - the trade deficit.

The U.S. Trade Deficit

In 1986, America had a $169.8 billion merchandise trade deficit. The deficit's growth has been a consequence of rising imports in recent years while exports have been essentially unchanged (Table 1). In 1986, imports were up 7 percent over 1985 and were 50 percent higher than in 1980. Increased imports were to be expected following 1982, when U.S. economic expansion began again. Of greater concern is that during this same period exports have remained flat, rising only about 2 percent this past year. They still remain slightly below their 1980 level.

The 1986 merchandise trade deficit grew vis-a-vis virtually every major U.S. trading partner (Table 2). In dollar terms, the biggest changes were with the European Community and Japan, but countries such as Korea and Taiwan now also have major trade surpluses with us. In terms of product components, changes in our manufactures trade dwarf any other shift. In manufactures, there has been a net swing of -$158 billion since 1980.

As America's merchandise trade balance has worsened, so has the current account balance. On the basis of three quarters' data, the 1986 current account deficit is estimated to be about $140 billion, 19 percent larger than in 1985. As recently as 1981, we had a current account surplus of $6.3 billion. The current account is the broadest measure of our international trade, including not only the merchandise trade balance but also the balance on trade in services, investment earnings and transfers.

The deterioration in America's trade and current account balances should concern all of us. However, before we try to "do something" we need to understand just what the problem is. Our trade and current account balances will permanently turn around only if we act to address their real causes, rather than their perceived causes.

Our growing current account deficit is, by definition, the mirror image of our growing net foreign capital imports (Table 3). In recent years, we have moved from being a large net capital lender to a substantial net capital borrower. Between 1982 and 1986, we borrowed almost $420 billion more than we loaned overseas. In other words, our problems are as much capital related as they are trade related.

Let me explain how the current account deficit mirrors our net foreign capital imports. Since 1982, the United States has been a particularly attractive haven for foreign lenders and investors. Sustained, noninflationary growth; relatively low taxes; business deregulation; and relatively high real interest rates have all helped to attract foreign funds.

In order to invest or lend here, however, foreigners have to purchase dollars in foreign exchange markets. That strong external demand caused the dollar to appreciate substantially during the first half of the 1980s. The appreciation, in turn, was a major factor in our large trade and current account deficits. After all, not many Americans give dollars to foreigners so that the latter can invest here. Foreigners earn those dollars by selling us goods and services.

Our trade and current account deficits supply the dollars purchased by foreigners in foreign exchange markets. Under the flexible exchange rate system, the dollar's value moves whenever necessary to equate the value of capital inflows with the current account deficit. Conversely, there is no way for our current account deficit to decline without a corresponding reduction in our net capital inflows (our net foreign borrowing).

The basic question then is why our net foreign borrowing is so high. The answer - our national pool of savings (the positive savings of private households, corporations and state and local governments) is insufficient to meet the combined expenditure demands of private investment plus the large federal budget deficit. The gap (3.3 percent of GDP in 1986) between domestic savings, on the one hand, and private investment plus federal budget deficits, on the other, must be made up by borrowing substantial amounts of foreign capital.

This borrowed capital lets us keep investment at current levels rather than reducing it to the level of domestic savings as would otherwise be necessary. We are saddling future generations of Americans with a growing domestic and foreign debt burden so that we can enjoy greater comforts today. Would that our grandchildren were to understand what we are doing to them.

One reason low net U.S. saving is not adequate to meet domestic expenditure is that there has been substantial dissaving by the federal government through large budget deficits. The most important action we as a nation can take to improve the trade deficit and enhance U.S. competitiveness is to boost domestic saving by cutting the federal budget deficit. Such action should be taken through reductions in government spending, since attempts to raise taxes would be counterproductive.

Another important factor contributing to the worsening of our trade and current accounts has been slow economic growth in many of our industrialized trading partners. This, of course, impedes growth in our exports. Were our overseas trading partners to grow faster, the net effect on U.S. exports would be positive. In addition, those countries would become more attractive to global investors, thereby reducing the demand for dollars to invest in the United States. (The latter is a two-edged sword, of course. A slowdown in foreign investment here will drive up interest rates, unless we also take steps to boost domestic savings.)

Finally, our trade and current account deficits are related to the debt crisis in the developing countries. Secretary Baker has covered this point, so I will only say that heavy debt burdens have caused many of our Latin American trading partners to reduce their imports from us while boosting exports to the United States in order to service their debts. That may have been a prudent and necessary strategy in the short run. It is not necessarily a sound strategy, either for them or for us, in the long run.

The Positive Side

We need to keep our trade problem in perspective. Notwithstanding our present trade woes, we still have one of the world's most competitive and productive economies. We can and must do better, but our competitive posture today is far superior to what it was two or three years ago. The Administration, the Federal Reserve, the Congress and the American people can all take pride in the restoration of sustained, noninflationary growth.

Beginning in 1981, President Reagan and the Congress worked together to free the inherent strength in our economy by dramatically reducing the tax burden borne by Americans. As a consequence, our economy is far stronger and more vibrant than it was when the Administration first took office.

In 1980, America was in the grip of the highest inflation rate we had ever seen. Inflation was silently stealing money from all our pockets. From a high of over 12 percent in 1980, inflation was cut to 1.1 percent in 1986, the lowest level in 25 years.

Accompanying this fall in inflation has been a significant drop in interest rates. The prime rate has been cut by almost two-thirds, from a crippling high of 21.5 percent in January 1981 to 7.5 percent in December 1986. Housing is once again affordable to Americans, sparking a boom in the domestic housing market.

Our ability to create jobs for Americans is the envy of the rest of the world. Since 1980, nearly 13 million new jobs have been filled. More than 61 percent of our people over the age of 16 are employed, the highest level ever. While civilian unemployment remains too high at 6.7 percent, it is now the lowest it has been since the end of 1979.

Despite cries to the contrary, U.S. manufacturing is not "deindustrializing" and has shared in the economic recovery. In real terms, manufacturing as a share of our gross national product (GNP) was 21.7 percent in 1985 (the most recent year available), its highest level since 1979. Although still below its 1979 peak, manufacturing employment in 1986 was 800,000 jobs higher than in 1982. And the rise in manufacturing productivity has led the economy. In 1986, manufacturing productivity grew 2.7 percent, following on 1985's substantial gain of 4.4 percent. In contrast, productivity in the economy as a whole grew only 0.7 percent in 1986 and 1.0 percent in 1985.

Thanks to the efforts of Treasury Secretary Baker, Chairman Volcker and their counterparts in other major industrial countries, we have seen a growing degree of macroeconomic coordination.

The Administration and the Congress together have completed a major overhaul of the tax system. The new system, which starts to take effect this year, will make our federal income tax simpler and fairer for millions of Americans.

The totality of all our economic policies has helped create over 49 months of sustained economic expansion, one of the longest periods of continuous growth since the second World War. This growth has boosted national wealth, given Americans higher real incomes than ever before and raised our standard of living.

Trade Policy and the Trade Deficit

Hand-in-hand with these general economic accomplishments have been numerous victories in the trade policy area. The Administration remains committed to its policy of free and fair trade. However, if trade is to be truly free for all countries, it must be conducted by essentially the same rules everywhere.

We have challenged and will continue to attack foreign unfair trade practices and trade barriers whenever and wherever they exist. They undermine the basic concepts on which the postwar trading system was built - equal access to open markets. And to individual industries and firms, foreign trade barriers and unfair trade practices can and do cost large amounts in lost sales opportunities.

The Administration has made major progress in removing foreign impediments to U.S. trade. Yet while we have achieved much, we have much yet to achieve. I will submit an overview of our accomplishments as an appendix to my testimony today. Let me summarize some of those actions.

Through the considered use of Section 301, we now have agreements with many of our trading partners to eliminate or substantially reduce barriers to U.S. exports. This Administration has launched more than 60 percent of all Section 301 trade actions. President Reagan is the first President to self-initiate Section 301 cases.

Since September 1985, we have initiated eight such cases and have brought seven of them to a satisfactory resolution.

In response to a Section 301 case, Japan will open its cigarette market, creating the possibility of a substantial increase in U.S. exports. On semiconductors, we have a broad settlement of a Section 301 case and two antidumping actions. In settlement of a Japanese leather and leather footwear case, the Japanese have agreed to reduce or eliminate tariffs on 137 non-leather items, including five important aluminum products, and they will make permanent 242 earlier tariff reductions.

With the European Community, we have just concluded a major dispute over the EC's enlargement to include Spain and Portugal. Under the agreement, the United States will receive full and fair compensation worth $400 million for losses we would otherwise have suffered in our corn and sorghum exports to Spain. More than three-quarters of the compensation came in assured access for corn and sorghum; the remainder in additional access on 26 other agricultural and industrial products. In other cases against the EC, we have reached settlements on citrus, pasta, almonds and canned peaches and pears, giving U.S. exporters an improved chance to compete in the EC market.

In other Section 301 actions, we negotiated settlements with Korea over two separate cases involving insurance and intellectual property. And the United States and Taiwan have settled a dispute over Taiwanese restrictions on its beer, wine and cigarette markets, creating perhaps $150 million in additional U.S. exports.

Section 301 is not the only weapon we have used to ensure that trade is conducted on a free and fair basis. We have now completed a two-year review of the Generalized System of Preferences (GSP) program, during which GSP beneficiaries were urged to improve intellectual property rights protection and worker rights practices and to eliminate barriers to U.S. exports of goods, services and investment. As a result of the review, the level of duty-free GSP benefits granted to advanced developing countries will be reduced by about $2 billion, or 23 percent. In addition, three countries were denied GSP benefits for failure to improve workers rights practices.

In the first use of our Section 307 authority, Taiwan has agreed to eliminate export performance requirements in the automotive sector. At the end of December, we settled a protracted subsidy/ countervailing duty dispute with Canada over its lumber pricing practices.

We have made important progress with Japan in the Market-Oriented Sector Selective (MOSS) talks to open markets to U.S. products. In telecommunications, pharmaceuticals, forest products and electronics, agreements were reached that should increase market access for U.S. firms. In August 1986, another MOSS negotiation was launched on auto parts/transportation equipment.

Along with more than 50 of our major trading partners, we have successfully renegotiated a renewal of the Multifiber Arrangement (MFA) in textiles and apparel to 1991. Coverage has been expanded to previously uncontrolled fibers such as ramie, linen and silk blends. The new accord also includes a mechanism to prevent destructive import surges and provisions to prevent fraud. During the discussions, we made it clear to our trading partners that we would continue to pursue measures in our bilateral agreements negotiated under the MFA to open markets to our textile exports.

Following a determination that a substantial increase in machine tools imports could threaten U.S. national security, President Reagan announced a program to revitalize the domestic machine tool industry. As part of that program, the President instructed Secretary Baldrige and me to discuss voluntary restraint agreements (VRAs) with Japan, Taiwan, Germany and Switzerland. We now have agreements with Japan and Taiwan. Given recent exchange rate movements, it is unlikely that machine tool imports from Germany and Switzerland will increase. If, however, there is a surge from those countries and if it threatens to undermine our VRAs, the President has reserved the right to take unilateral action. He has also approved a domestic action plan to boost the machine tool industry.

In what may be our single most important international endeavor for 1987, we are in the midst of negotiations on a comprehensive trade agreement with Canada, our largest trading partner. Merchandise trade flows between our two countries totalled $114 billion in 1986. We believe those numbers will grow dramatically if we can open up the border between our two nations. We also see a vast expansion of activity in the services sector, in investment flows, and in capital movements generally. These negotiations are complex and very sensitive, but they are also clearly in the economic interest of both countries. We hope to bring them to completion later this year.

The Administration's Program to Maintain and Enhance U.S. Competitiveness

In a world that has changed dramatically in the last 40 years, one constant remains. Other countries look to America for economic leadership. We can lose that leadership role only through our own inadequacies. It is we, no one else, who will determine whether we are internationally competitive a decade from now. If we are not, we will have only ourselves to blame.

The growth in our trade deficit has caused some observers to ask if we really can meet the challenge of the international marketplace. As clearly stated by President Reagan in his State of the Union message, his answer is an emphatic "yes, we can!", provided business, labor and government put their heads together and work cooperatively toward that goal.

As the President noted, all Americans must work together in a national "quest for excellence." This Administration is committed to doing its part to foster and promote America's ability to compete, as others must also do their part.

The federal government's role should be to create an environment in which American business and workers can achieve their full potential. As part of the Administration's initiative to enhance U.S. competitiveness, the President has made wide-ranging proposals designed to do just that. The multi-pronged program is aimed at:

- increasing our investment in human and intellectual capital;
- boosting scientific and technological development;
- improving protection for intellectual property rights;
- refining our legal and regulatory systems;
- creating a favorable international economic environment; and
- eliminating the budget deficit.

Enhanced U.S. competitiveness requires first and foremost increased investment in our most valuable national resources - our human and intellectual capital. This investment must start as early as possible, when our children are in school. One of our goals is to broaden and deepen our children's command of basic skills. In today's world, knowing the three "r's" is not enough. Ours is a technological society in which a knowledge of computer languages is becoming as important as a mastery of English. Americans must be well-versed in every area, not only in English but in the new language of science and technology. The slide rule has been replaced by the personal computer, and our children had better know how to use it!

Preserving human capital also means helping those workers who become displaced from their jobs. The President will propose a new $1 billion worker adjustment assistance program to help experienced industrial and service workers and farmers find new employment when they lose their jobs. It will include job counseling, and job search assistance and training for workers long before they exhaust their unemployment benefits. There will also be an $800 million program for training needy youth in welfare families. Under the leadership of Secretary of Labor Brock, the Administration will also seek ways to improve labor mobility, so that workers can move more freely to areas where jobs are being created.

U.S. competitiveness is highly dependent on our ability to take quick advantage of our knowledge and technological breakthroughs. The government has at least two roles in this area. First, it can promote the generation of new knowledge and technology. Toward this end, the President will put forth several initiatives to foster U.S. research and development. Among these are science and technology centers that will focus on basic science directly affecting our competitiveness; increased research and development incentives; the encouragement of technology sharing among government, universities and business; and accelerated spin-offs from defense technologies.

Promoting increased knowledge and technological development is only half the battle. It will do us little good to develop new technologies, only to have them immediately pirated by other countries as has so often occurred this past decade. We are determined to improve protection for U.S. intellectual property rights at home and abroad. We will seek improvements in domestic law to give greater protection to holders of such rights, and abroad we will take into account the degree to which a country protects intellectual property rights when we negotiate treaties or provide assistance. We also plan to join the Berne Convention for the Protection of Literary and Artistic Works.

Our laws and regulations impose unnecessary burdens on American business. Oftentimes, the greatest hurdle for an American exporter is our own rules. Instead of promoting exports, we discourage them! Among the areas that we will have proposals on are changes in product liability laws to reduce spiraling insurance costs; reform of our antitrust laws so that they reflect the reality of global markets; modified export controls; additional reforms to eliminate unnecessary regulatory burdens; deregulated surface transportation and natural gas; and a strengthened private pension system.

Trade Legislation and the Uruguay Round of Multilateral Trade Negotiations

America is the world's most important trading nation. Through trade, we have stimulated economic growth, taken advantage of economies of scale, encouraged innovation, and ensured a higher U.S. standard of living. Some 5 million American jobs depend on exports - more than in any other nation. The days when we could wall ourselves off from the rest of the world are gone, never to return.

That is why the Administration, as part of its program to enhance U.S. competitiveness, will submit to the Congress a substantial package of trade legislation. It is our hope that we can work together to give this legislation the serious and thorough consideration it deserves.

One of our legislative goals is to improve the scope and functioning of U.S. trade law. In so doing, we will submit amendments to Section 201 of the Trade Act of 1974 to expand the range of relief remedies available to the President, and to help ensure that industries receiving Section 201 relief will be truly competitive following the period of relief. We will propose including reciprocity as a factor to be considered under Section 301 - our most powerful trade weapon - in deciding whether a government's practices are "unreasonable". We will also propose a firm time limit for settling all Section 301 disputes and regular reports on the commercial effects of Section 301 actions. Our antidumping and countervailing duty laws should be tightened to prevent circumvention. In addition, the antidumping law should be amended to improve its application to nonmarket economies. Our legislative proposal will also contain a request for authority to implement the Harmonized System of Tariffs.

The other goal of our proposed legislation will be to give us the tools to improve the international trade environment.

The tool we need most is the authority and fast track procedures for negotiating and implementing new trade agreements. To achieve fairer international trading rules and to knock down the many foreign barriers distorting international trade, we cannot depend on our unilateral options. We must negotiate with foreign countries, and we must be prepared to implement the results of those negotiations in this country.

Faced with intensified foreign competition here and abroad, our options for independent action in the trade area have serious limitations. On our own, we can close our own market, and we can subsidize our exports. We have taken such steps on occasion when provoked by unfair foreign practices, and the Administration is proposing certain strengthened legislative provisions in this regard in order to meet unfair foreign competition.

But as a general policy, painful experience tells us that such steps are likely to hurt U.S. consumers, drain our treasury and provoke foreign retaliation. These actions hurt, rather than help, our competitiveness. It is not in our interest to foster dependence on protection and subsidies; rather we want more open foreign markets and fair rules of international competition. To achieve this, we cannot merely bludgeon other nations with threats of U.S. restrictions. We must be able to negotiate credibly for global liberalization.

In general, the best prospect for achieving significantly improved market opportunities and fairer international rules comes through multilateral trade negotiations. We successfully launched the Uruguay Round last September, with by far the broadest agenda in the history of GATT negotiations. It includes not only traditional areas of GATT concern, but also new areas of international economic activity, including services, trade-related investment measures, and intellectual property rights, as well as improved rules for agriculture and dispute settlement. While we must be prepared also to negotiate bilaterally and through other types of initiatives, our primary focus lies in the multilateral approach of the Uruguay Round.

For more than 50 years, successive administrations and Congresses have recognized that successful negotiations in the trade area require a partnership between the Congress, with its Constitutional power to regulate foreign commerce; and the President, who has the Constitutional responsibility for international negotiations.

While I do not want to address today every aspect of S. 490, one of the major flaws of that bill, Mr. Chairman, is that it provides only the possibility of a fast track at some future time. In fact, the bill precludes access to the fast track process until the Congress votes to approve certain trade policy statements. That vote could easily degenerate into a referendum on whatever Administration is in power, or on the topical issue of the moment!

S. 490 will reduce the confidence level of other governments in America's commitment to multilateral trade negotiations. This undermines our leverage in these negotiations, and it could even torpedo the Uruguay Round itself. It would certainly end any hope of early results from the Round. In this area, S. 490 outlines a very high risk strategy. In our judgment, it is an intolerably high risk, and it is inappropriate public policy.

Conclusion

Many policy solutions for the U.S. trade deficit have been debated in the Congress, the public and the press - an import surcharge, oil import fees, export promotion and subsidy programs, forced reductions of bilateral trade surpluses by major U.S. trading partners, and the tightening up of U.S. trade laws and programs.

Many of these proposals are of dubious merit; some would be very harmful to U.S. interests. In general, they blatantly ignore our international commitments and responsibilities. They would invite retaliation, shrink trade, slow everyone's economic growth, and boost our inflation rate. Aside from their specific shortcomings, these proposals all share one basic flaw - they fail to address the fundamental causes of the trade deficit.

They fail because they attempt to force "traditional" trade policy instruments, such as our trade laws, to solve problems they were never designed to solve. The proposals focus mainly on mechanisms which directly affect trade in goods - tariffs, quotas, retaliatory authority, export promotion activities, etc. Even where such proposals move outside of the traded-goods sector and into such new areas as services, intellectual property rights and investment, they implicitly assume that herein lies the solution to our $170 billion trade deficit. Those who advocate such a course of action could not be more wrong.

Such matters are a legitimate subject for public discussion. Traditional trade policy is still important, and we are working very hard at it. But let us recognize that trade policy is not responsible for much of the recent expansion in our trade deficit. At most, foreign trade barriers and unfair trade practices account for a very small portion of our trade deficit. Indeed, given the Administration's record in attacking unfair foreign practices, if trade policy were a major factor in the trade deficit we would already have eliminated a large chunk out of it.

Actions in the trade area should be taken because they are needed to maintain and restore a sense of equity and openness in the international trading system. But they are not the fundamental solution to our trade problems. Neither legislative action nor the aggressive pursuit of unfair trade cases will cure our trade deficit. The cure lies elsewhere.

In looking for solutions we must expand our horizons beyond those of traditional trade policy. The Administration's competitiveness, trade and macroeconomic policy initiatives are positive, forward-looking and aggressive. They reflect President Reagan's confidence in America and its people. We want to work with the Congress in a determined effort to enhance our competitiveness and expand our international trading opportunities so that we can guarantee a better future not only for all Americans, but for all nations.

Table 1

Trade and Current Account Balances
($ billions)

a. Merchandise Trade (Census basis, imports valued c.i.f.)

	U.S. Exports	U.S. Imports	Balance
1980	220.6	257.0	- 36.4
1981	233.6	273.4	- 39.8
1982	212.2	254.9	- 42.7
1983	200.5	269.9	- 69.4
1984	217.9	341.2	-123.3
1985	213.1	361.6	-148.5
1986	217.3	387.1	-169.8

b. Current Account Balances

	Merchandise**	Business Services	Direct Invest. Earnings	Other Invest. Earnings	Other***	CURRENT ACCOUNT
'80	- 25.4	7.6	28.5	1.9	-10.7	1.9
'81	- 28.0	9.6	25.7	8.4	- 9.9	6.3
'82	- 36.4	9.1	18.2	10.4	-10.4	- 9.1
'83	- 67.1	6.4	14.9	9.9	-10.7	- 46.6
'84	-112.5	2.3	12.3	6.5	-15.1	-106.5
'85	-124.4	0.4	26.3	- 1.1	-18.9	-117.7
'86*	-146.4	4.6	31.2	- 8.4	-20.6	-139.6

* Annualized from the first three quarters of 1986

** The merchandise trade deficit as reported in the current account is smaller than on the more widely reported Census basis. The exclusion of insurance and freight charges from merchandise import valuations in the balance of payments together with other technical adjustments cause this difference in the valuation of the trade balance.

*** Includes military transactions, government services and unilateral transfers

Sources: Survey of Current Business
U.S. Department of Commerce
U.N. Trade Statistics

Table 2: SELECTED BILATERAL U.S. MERCHANDISE TRADE BALANCES - 1980 TO 1986

	1980	1981	1982	1983	1984	1985	1986
Japan	-12.0	-18.0	-19.0	-21.7	-36.8	-49.7	-58.6
Canada	-6.6	-7.3	-13.1	-14.3	-20.4	-22.2	-23.3
EC	16.3	8.7	3.5	-1.6	-13.3	-22.5	-26.4
Germany	-1.9	-2.1	-3.8	-5.0	-9.4	-12.2	-15.6
Mexico	2.4	3.8	-4.0	-7.9	-6.3	-5.8	-5.2
Korea	0.0	-0.5	-0.7	-2.0	-4.2	-4.8	-7.1
Taiwan			-5.4	-7.7	-11.3	-13.1	-15.7
Brazil	0.3	-1.0	-1.2	-2.9	-5.6	-5.0	-3.5

SOURCE: U.S. Department of Commerce and the Office of the U.S. Trade Representative

Table 3: Selected Data on U.S. Capital Flows, 1981 to 1986
(Billions of U.S. Dollars)

Item	1981	1982	1983	1984	1985	1986*
Capital Outflows (-)	-111.0	-121.3	-50.0	-23.6	-32.4	-90.0
of which						
Debt	-96.2	-117.2	-44.6	-15.9	-5.9	na
Equity	-9.6	0.9	-4.3	-5.0	-22.7	na
Capital Inflows (+)	83.3	94.1	85.5	102.8	127.1	204.4
of which						
Debt	53.1	76.7	67.2	78.3	104.4	na
Equity	30.2	17.4	18.3	24.5	22.7	na
Net Capital Flows	-27.7	-27.2	35.5	79.2	94.7	114.4
of which						
Debt	-43.1	-40.5	22.6	62.4	98.5	na
Equity	20.6	16.5	14.0	19.5	0.0	na
Current Account Deficit	6.3	-9.1	-46.6	-106.5	-117.7	-139.6
Errors and Omissions	21.4**	36.3	11.1	27.3	23.0	25.2

* Annualized on the basis of 9 month's data.
** Includes allocation of SDR drawing rights.

Note: In the categories "Capital Outflows" and "Net Capital Flows", debt plus equity do not equal the total capital flow because of changes in U.S. official reserve assets.

Source: U.S. Department of Commerce, Survey of Current Business.

OFFICE OF THE UNITED STATES
TRADE REPRESENTATIVE
EXECUTIVE OFFICE OF THE PRESIDENT
WASHINGTON
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THE PRESIDENT'S TRADE POLICY: AN UPDATE

On September 23, 1985 President Reagan outlined a trade policy consisting of three parts: tough action against other nations' unfair trade practices, negotiations to liberalize world trade, and international economic policy reforms that would help both U.S. exporters and import-sensitive industries.

The President's policy has achieved major progress on all fronts. Here is a summary of its achievements.

I. FIGHTING UNFAIR TRADE

Since September 7, 1985, President Reagan has instructed U.S. Trade Representative Clayton Yeutter to initiate or take action on eleven unfair trade practice cases under section 301 of the Trade Act of 1974. Ten of these cases have been resolved and President Reagan has issued an unfairness finding in the other.

The aggressive use of section 301 and other statutes is achieving results:

EC Enlargement

> The European Community (EC) agreed on January 30, 1987 to provide full compensation to the U.S. for higher corn and sorghum tariffs imposed in Spain following that country's accession to the EC. The $400 million compensation package includes guaranteed imports of 2 million metric tons of corn and 300,000 metric tons of sorghum by Spain. Another 400,000 metric tons of grain may be sold in Portugal as a result of elimination of a requirement reserving 15 percent of the Portuguese grain market for sales from other EC member countries. The EC will also lower tariffs on 26 other products to provide additional market access and extend all current EC tariff bindings to Spain and Portugal. These actions were taken after President Reagan had announced retaliatory measures under section 301.

Japan Tobacco

> Japan agreed on October 6, 1986 to open its cigarette market to U.S. cigarette exporters by suspending its 28 percent

tariff on cigarette imports, by ending the discriminatory practice of allowing deferred payment of excise taxes by Japanese manufacturers and by eliminating distribution and price approval problems. U.S. cigarette exporters believe their exports to Japan could quintuple, reaching $1 billion annually. This settled a self-initiated section 301 case.

Taiwan Beer, Wine and Tobacco

Taiwan agreed to open its beer, wine and cigarette markets to American exports, creating the possibility of an additional $150 million in sales in these commodities. This action was taken on December 8, 1986 after President Reagan instructed Ambassador Yeutter to propose retaliatory action under section 301.

Japan Semiconductors

Japan agreed on July 31, 1986 to open its market to sales of U.S. semiconductors, which should increase semiconductor exports by $2 billion in five years. Japan also agreed to help ensure that Japanese companies will quit dumping computer chips below cost in the U.S. and third country markets. This settled an industry-initiated section 301 case and two antidumping cases.

-- The Administration is monitoring this agreement carefully in light of apparent noncompliance by Japan. In emergency consultations in Tokyo the week of January 26, U.S. negotiators set deadlines for Japanese actions to bring them into full compliance with the provisions of the agreement.

Brazil Informatics

In another self-initiated section 301 case, President Reagan determined on October 6, 1986 that Brazil unreasonably restricts imports of computer technology, provides inadequate protection of intellectual property rights for computer software and restricts investment in the computer sector. Based upon progress made to date and upon expectations of future progress, President Reagan decided on December 30, 1986 to provide an additional period until July 1, 1987 for Brazil to make improvements in its informatics regime.

EC Citrus, Pasta, Almonds

The EC agreed on August 10, 1986 to give U.S. citrus producers additional access to the European market, ending a 16-year dispute on the EC's special treatment for Mediterranean citrus imports. The EC also agreed promptly to solve the long-standing problem of subsidies for EC pasta exports. And the U.S. and EC agreed to tariff reductions on other products that will give U.S. almond producers additional access to the European market. These agreements were reached after President Reagan retaliated against the EC's citrus preferences under section 301, raising pasta duties on November 1, 1985. (As part of the settlement, both sides rescinded their retaliatory measures).

Japan Leather

Japan agreed on December 21, 1985 to compensate the U.S. for GATT-illegal leather and leather footwear quotas by eliminating tariffs on 137 items, including five important aluminum products, and making permanent 242 earlier tariff reductions. In addition, the U.S. imposed higher duties on Japanese leather imports to the U.S. This settled a long-standing section 301 case on which the President set a deadline for retaliation.

Japan Aluminum

Following consultations required as part of the leather agreement, Japan agreed on October 31, 1986 to accelerate tariff reductions on aluminum imports.

Korea Insurance

Korea agreed on July 21, 1986 to eliminate prohibitions against underwriting by foreign firms of life and non-life insurance, ensuring fair access for U.S. firms to Korea's $5 billion insurance market.

Korea Intellectual Property

Korea agreed on July 21, 1986 to offer significantly greater protection to U.S. intellectual property rights, including patents, copyrights and trademarks, settling a self-initiated section 301 case.

Korea Motion Pictures

A potential section 301 case was avoided when Korea agreed on December 23, 1985 to reduce its barriers on importing and distributing of U.S. motion pictures, television programs, and video materials.

Taiwan Customs Valuation

Taiwan agreed on August 11, 1986 to fulfill its commitment to use the transaction value, instead of an artificial duty paying schedule, to calculate customs duties. This action came after the President directed Ambassador Yeutter to propose retaliation under section 301.

EC Canned Fruit

The EC agreed in December 1, 1985 to phase out the processing element of subsidies for canned peaches and pears, giving U.S. canned fruit exporters a chance to compete in the EC market. This settled a long-standing section 301 case on which the President set a deadline for retaliation.

In addition to section 301, President Reagan has used other statutes to fight unfair trade:

Canada Lumber

On December 30, 1986 the United States and Canada settled a long-standing dispute over Canada's lumber pricing practices. Canada agreed to implement a 15 percent export tax on lumber, thereby neutralizing the effect of its lumber subsidies.

Generalized System of Preferences (GSP)

On January 2, 1987 Ambassador Yeutter announced that President Reagan will reduce the level of duty-free GSP benefits available to advanced developing countries by an estimated $2 billion, or 23 percent. This decision concluded a two-year general review of the GSP program which encouraged improved protection of intellectual property rights and the elimination of foreign trade barriers to U.S. goods, services, and investment. The President also decided to terminate or suspend from the program three countries for their failure to improve their worker rights practices.

Taiwan Investment Restrictions

Taiwan agreed on September 12, 1986 to eliminate export performance requirements in the automotive sector. This occurred after the President instructed Ambassador Yeutter to initiate a case under Section 307 against trade related investment restrictions by Taiwan, which had imposed export requirements on a Japanese auto plant investment there.

Brazil General Aviation Aircraft

Following several years of consultations, Brazil agreed in late 1985 to reduce import restrictions on general aviation aircraft by lowering tariffs from 50 to 20 percent, by granting import licenses for aircraft under 7,000 kilograms within 30 days and by making licensing procedures more transparent.

Japan Supercomputers

The United States initiated a Section 305 investigation of Japan's supercomputer trade practices on December 10, 1986, thereby launching an interagency fact-finding review of trade in one of America's most advanced industries. The United States and Japan will also discuss the issue of Japanese procurement of supercomputers under the auspices of the Market-Oriented Sector Selective (MOSS) electronic talks.

Japan Rice

Ambassador Yeutter announced a strategy for dealing with Japanese restrictions on rice imports on October 23, 1986. Under this strategy, the U.S. will ask Japan to honor commitments made in Punta del Este, Uruguay to roll back GATT-illegal trade measures and to negotiate on all agricultural issues during the Uruguay Round negotiations.

Japan Airport Construction

Japan has assured the U.S. that foreign companies will be able to compete on a fair and equal basis in the second and third construction stages at the $8.5 billion Kansai airport in Osaka Bay. Consultations continue on American participation in the airport construction.

War Chest

On September 23, 1985, the President proposed a $300 million three-year fund to counter predatory export credit financing by U.S. competitors for projects in developing countries. Congress appropriated $100 million last year for this purpose. The Administration is seeking the additional $200 million for the next two years.

Sweaters from China and Macau

The U.S. used new authority under the Multifiber Arrangement (MFA) to establish quotas on such products as ramie, linen and silk-blends for the first time on September 3, 1986 when, following import surges in these products, it notified China and Macau that it intended to limit "new MFA fiber" sweaters from those countries.

Japan Fish Quotas

GATT consultations requested by the United States regarding

Japan's quotas on fish -- particularly herring and pollock -- began on October 22, 1986.

Japan Agricultural Quotas

On July 15, 1986, the U.S. asked for a GATT investigation of illegal Japanese import quotas in 12 agricultural categories, including fruit juices and processed beef. A GATT panel has been established to investigate the U.S. claim.

EC Airbus

On December 19, 1986, Ambassador Yeutter requested political-level round of consultations with three European governments on the Administration's complaint that they improperly subsidize Airbus Industrie. Those talks were held during the week of February 2, 1987.

EC Meat Inspection

On March 31, 1986, President Reagan instructed Ambassador Yeutter to initiate an inquiry under Section 305 into unnecessary inspection standards the EC intends to enforce against meat imports.

Preshipment Inspection

Ambassador Yeutter announced actions on October 20, 1986 that will address impediments to American exports caused by requirements by some countries that shipments be inspected by private companies in the U.S. before export.

GSP Ethanol

On April 1, 1986, the President determined that certain ethanol mixtures were being imported in circumvention of U.S. law and would no longer be eligible for duty-free treatment under the Generalized System of Preferences (GSP).

Shakes and Shingles

On May 22, 1986, the President granted import relief to the red cedar shakes and shingles industry under section 201 in the form of a declining tariff program.

II. NEGOTIATING TRADE AGREEMENTS

President Reagan is seeking a worldwide negotiation to improve international trading rules as well as a wide array of bilateral agreements to open overseas markets for U.S. exporters and to shield import-sensitive industries from unfair imports.

Uruguay Round

On September 20, 1986, in Punta del Este, Uruguay, trade ministers from the 92 nations in the General Agreement on Tariffs and Trade (GATT) launched comprehensive multilateral trade negotiations under the GATT. The talks will strengthen the international trading system so that U.S. manufacturing, services and agricultural industries can better compete in international markets. The U.S. will seek new rules covering trade in services and agriculture, trade-related investment, intellectual property protection and dispute settlement.

Canada FTA

An historic negotiation with Canada designed to liberalize trade between the two nations began on June 17, 1986. If successful, the talks could lead to the virtual elimination of the border for commercial purposes, strengthening both countries' ability to compete in international trade.

MFA

Textile exporting and importing nations agreed to a stronger and more comprehensive extension of the Multifiber Arrangement (MFA) on August 1, 1986. The new MFA extends product coverage to essentially all fibers and makes it easier to prevent import surges.

Machine Tools

On December 16, 1986 President Reagan announced that Japan and Taiwan had voluntarily agreed to restrain machine tool exports to the United States for five years. He also approved a domestic action plan that will facilitate the industry's revitalization. This program, which will last five years, was undertaken for national security purposes.

Japan MOSS

Important progress was achieved in 1985 in the Market-Oriented Sector-Selective (MOSS) talks with Japan to open markets for U.S. products. A number of market-opening measures are to be implemented while talks will continue to open markets even further.

-- In the telecommunications area, the Japanese market was opened substantially to American radio equipment and services, terminal equipment and network services.

- -- Barriers to imports of American medical equipment and pharmaceuticals were reduced by simplifying regulatory procedures, eliminating administrative delays, and making the rules and regulations more understandable.

- -- In electronics, several important measures were approved that should improve access by U.S. companies to the Japanese market, including tariff reductions, improvements in the patent process, participation by U.S. companies in Japanese R&D projects, and legal protection for semiconductor chips and computer software.

- -- In forest products, the Japanese government has committed to tariff reductions on wood and paper products. The talks will now focus on non-tariff barriers.

- -- On August 20, 1986, the U.S. and Japan began negotiations on the next MOSS negotiation area -- auto parts.

Japan NTT Agreement

On December 23, 1986 Japan agreed to a three-year renewal of the bilateral agreement on procurement of telecommunications equipment by the Nippon Telegraph and Telephone Company. Under this agreement, the government of Japan must provide nondiscriminatory treatment for U.S. products in procurement, ensuring the ability of U.S. suppliers to compete in a market that formerly was closed to foreign suppliers.

EC Steel

On November 1, 1985, the EC agreed to hold steel exports to 5.5 percent of the U.S. market through September 30, 1989. The U.S. has now negotiated 18 such agreements with steel-producing countries. These agreements are designed to correct market distortion caused by foreign practices such as subsidies, dumping, and quotas.

- -- On August 10, 1986, the EC agreed to limit semifinished steel exports to the U.S. to approximately 600,000 tons annually. This agreement brings semi-finished steel under the discipline of the U.S.-EC Steel Arrangement for the first time.

Steel Surges

On September 4, 1986, Ambassador Yeutter requested immediate consultations with Canada, Sweden, and Taiwan to remedy the consultations with Canada, Sweden, and Taiwan to remedy the problem of steel import surges from those nations. This followed large monthly increases from these nations (which are not covered by the President's steel program) during July. Steel imports from Sweden and Taiwan have subsequently declined.

Mexico GATT

On August 24, 1986, Mexico acceded to the GATT following the negotiation with the U.S. of terms of accession that will guarantee greater access to the Mexican market for U.S. exporters.

Hong Kong Textiles

The U.S. and Hong Kong reached a comprehensive agreement on textile and apparel imports on June 30, 1986, limiting growth of Hong Kong textile and apparel imports to an average of one percent per year through 1991. This agreement also extended coverage to virtually all fibers, including ramie, silk blends and linen.

Taiwan Textiles

On July 14, 1986 the U.S. and Taiwan reached a comprehensive agreement on textiles and apparel similar to the agreement reached with Hong Kong. Under this agreement, Taiwan's exports will grow by about one-half of one percent from 1985 through 1988. In addition, Taiwan agreed to reduce tariffs on more than 300 textile and apparel items by as much as 50 percent, providing additional market access for U.S. manufacturers.

Korea Textiles

On August 4, 1986 the U.S. and Korea reached a comprehensive agreement on textiles and apparel that will limit import growth to 0.8 percent annually through 1989. In addition, Korea has agreed to phase out its import licensing system over three years, providing additional market access for U.S. manufacturers.

Japan Textiles

Japan agreed to a comprehensive agreement on textiles and apparel on November 13, 1986 that will limit import growth to 0.8 percent annually through 1989. In addition, Japan agreed to establish a mechanism to prevent transshipments of textiles from third countries through Japan.

Japan Computer Parts

The U.S. and Japan agreed on November 22, 1985 to eliminate all tariffs on trade in computer parts and Japan agreed to eliminate tariffs on computer peripherals and central processing units.

Japan Lawyers

On April 11, 1986, the U.S. and Japan announced an agreement permitting American lawyers to enter the legal services market in Japan for the first time. Consultations continue on implementation of the agreement.

Taiwan Pears

Taiwan agreed to liberalize restrictions on imports of pears as of September 15, 1986.

Colombia Wine

Following representations by Ambassador Yeutter to the President of Colombia, that nation removed U.S. wines from its list of prohibited imports.

BITs

Since March 25, 1986, President Reagan has sent to the Senate for ratification 10 bilateral investment treaties (BITs) liberalizing investment policies between the U.S. and developing nations.

Harmonized System

On July 25, 1986, the U.S. presented the GATT with a new U.S. tariff schedule bearing common nomenclature negotiated in the GATT over a 12-year period. U.S. exporters will benefit from the efficiency that results when the new system is phased in by all countries.

Government Procurement Code

GATT's Committee on Government Procurement completed the first phase of renegotiating the Government Procurement Code on November 21, 1986, strengthening the Code to bring the procurement practices of other signatories more into line with U.S. practices.

III. IMPROVING THE INTERNATIONAL ECONOMY

President Reagan has sought an unprecedented level of coordination of international economic policies among the leading developed countries to provide a more reasonable relationship between the dollar and other currencies to assist U.S. exporters and import-sensitive industries.

Plaza Agreement

Secretary Baker and representatives of four other industrialized nations agreed on September 22, 1985 to embark on a major effort to coordinate economic policies. The result has been a major realignment of currency exchange rates, which will begin to alter our trade imbalance soon and which has already made U.S. products and services far more competitive.

Tokyo Summit

The President achieved agreement at the Tokyo Economic Summit on May 6, 1986 on a package of reforms that will improve the international monetary system and provide a more stable international economic environment.

February 9, 1987

The **Chairman**. And we will take it for the record, and we will also take any questions for the record from members. But let me get to a couple of points here which, like many of the members, may be as much of a statement as it is a question.

I think it is absolutely critical that you have the support of the Congress in these negotiations, and I think if you don't have it then you are not going to have credibility and you are not going to get the job done.

We saw that happen when Lyndon Johnson was President. He went out and negotiated an agreement and did not have the backing of the Congress. When he came back with the agreement, it wasn't ratified. That was not lost on our trading partners or competitors. So, it is imperative, in my opinion, that you consult with this Congress, that it is understood by our trading partners that you are consulting and that they are not looking at something like an EC administrator said the other day—and I don't think he said it totally in jest—"It is time we start negotiating with the Congress."

You negotiate with this Congress. The Administration negotiates with this Congress. Let us get together on the objectives and the policy. We can't do the negotiation, and we shouldn't try; but we have a responsibility, a joint responsibility under the Constitution, that does affect policy. We want to know where you are headed if we are going to give the Administration a fast track.

Now, I congratulate you on getting agriculture and services on the agenda. I am pleased to see that. Getting it on the agenda and getting it considered and something done about it is quite a different thing.

Every major industrial nation in the world has a trade surplus with us. Why should they want to change the rules? From their standpoint, it is working just the way it is. Why give up some advantage they already have? Where is your muscle? How do you think you are going to be able to bring that about unless there is a serious threat of retaliation by the U.S.? Would you comment on that?

Ambassador **Yeutter**. Certainly, Mr. Chairman. First of all, with respect to the consultative responsibilities of the Executive Branch, that is not a subject even for debate, as far as I am concerned.

The **Chairman**. It sure was last year.

Ambassador **Yeutter**. Well, it was not with me. It may have been with some.

The **Chairman**. All right.

Ambassador **Yeutter**. It certainly has never been an issue with me, and I think you are well aware of that. It certainly was not when I was Deputy Special Trade Representative back in the mid-Seventies. I spent a lot of time consulting with the Congress at that time as well. So, that is not an issue subject to debate.

Neither is it a question with respect to consultation with the private sector. We have a lot of private-sector advisory committees, and we are spending a lot of time with them right now. I am spending a great deal of personal time, probably more than any predecessor USTR, and I intend to continue to do that.

So, the consultative process is a given, and in fact we will have some proposed language on that issue in our legislation that will come up later today.

Now, consultation is one thing; tying your negotiators' hands is another thing, Mr. Chairman, and we may have some debate as to what the word "consultation" means. Your friend and mine, Bob Strauss made some points on that when he testified before you recently. I agree with his basic point, that it is not in the interests of this country to tie the hands of the U.S. Trade Representative.

Certainly we should have discussion about our objectives and what our basic policy is and what we would try to achieve; but when one begins to rigidify that process, it can really turn out to be counterproductive, and we need to make darned sure that we don't do something that is going to make it more difficult for me and for the USTR to negotiate internationally instead of less difficult.

The CHAIRMAN. Mr. Ambassador, because of the limitation of time, let me make one more point here, because you had said you hope this doesn't degenerate into protectionism. I agree with that. It certainly shouldn't. But I get a little concerned about using the term "protectionism" when the Congress does something and the term "import relief" when the Administration does it. I don't see the difference. I was making that point to the Secretary before you.

I had a study made last year by the Congressional Research Service that showed that the Administration, on every; important trade bill introduced by a Republican or Democrat in the Senate, labeled it "protectionism." Then I heard the Secretary say that this Administration had granted more import relief than any Administration in 30 years. And I just heard a very prominent economist say this Administration is the most protectionist Administration since Herbert Hoover. What is the difference? Is it only in the eyes of the beholder?

If we are going to have cooperation between the Administration and this Senate, let us watch the rhetoric, because we have import relief now that is costing the American consumer $65 billion a year, more than twice as much as in 1980. Twenty-two percent of our imports are covered by some kind of special import protection; in 1980 it was 12 percent.

Ambassador YEUTTER. I agree, Senator Bentsen. I don't happen to think that is a healthy trend for the country. It may be a reflection of the times and a reflection of concerns such as those articulated by Senator Mitchell a bit ago. I was listening to some of that colloquoy, and I heard your colloquoy with Senator Baker on this point.

The CHAIRMAN. You can be forgiven for calling the Secretary "Senator Baker," I guess, just as much as I can be forgiven a moment ago for referring to "Senator Caucus." [Laughter.]

Ambassador YEUTTER. I think this is the second time I have done that here. But when Secretary Baker commented on it, he responded in a manner that is certainly consistent with my own views. Nearly half of that protectionism that you are talking about, Senator, lies in the textile and apparel area; and, as you know, that industry is back asking for more. All of us will face that issue this year.

There are times when import relief is appropriate. That is why we have Section 201 in the law, as you well know. We ought to take that on a case-by-case basis, and we ought to do what we believe is the right thing in terms of granting that relief if and when there is a persuasive case to do so.

But we ought not be tempted to go the general route of protectionism, because that is not a solution to our problems. That may be superficially appealing—you understand that as well as I do—but what is superficially appealing and perhaps even politically palatable or attractive is not necessarily the right thing for the country, and I hope we can do the right thing for the country.

The CHAIRMAN. Thank you.

Senator Roth?

Senator ROTH. Mr. Ambassador, as you well know, I have been deeply concerned that for many years almost any Administration has spoken with many voices in respect to trade. It has been my firm conviction for the last 15 years that the current organization is not adequate. And while reorganization will not necessarily solve the trade problem, it can help put trade on the front burner and enable this Administration or any future Administration to speak with a more effective single voice.

Now, I am not going to ask you today to give your personal comments on that matter, but I do think it is very important and that the time is here where we ought to give some careful consideration as to whether or not the administrative branch of government can't be better organized to promote U.S. interests in world trade.

I say I think the time is right. I don't propose that any changes be made in the remaining years of the Reagan Administration, but we are facing a new Presidential election in two years. I think the time is right that we ought to give careful thought and see if we can't come up with a better organization so that you won't have to say, as you did a few minutes ago, "Well, that was not my voice; that was someone else's." I think somewhere there has to be some focus on trade matters within our government. We need to support American exports so that we can meet the challenge from abroad.

The problem today, as you well know, is that trade is a divided function. You and your office has responsibility for negotiation, but administration and the collection of data and information is a matter for the Department of Commerce. That makes for conflict.

As I say, I am not looking for any answer today, but I do think this is something that is worthy of careful consideration, both within the Executive Branch as well as in the Congress itself.

Let me ask you: Is it realistic to expect serious progress will be made in trade negotiations if the Congress does not grant fast-track negotiating authority this year?

Ambassador YEUTTER. Okay. First of all, if I may make a peripheral comment on your introductory remarks about the organization of government, and this is not intended to be an official Administration position. I would simply say that organization of government is always a legitimate subject for public debate. This is an issue that you and I have discussed in the past, and an issue in which you have had a great deal of personal interest for a long period of time.

I have some particular views on that subject which I would be happy to share with you or the Committee at some point in time in the future; but suffice it to say that that is not the heart of the $170 billion trade deficit; we are not going to change that by shuffling places within government.

It is inevitable that there will be a lot of players in the trade policy process. It may well be that we could organize the functions somewhat differently and perhaps more appropriately than at present, but actually the system at the moment is working quite well insofar as policy deliberations are concerned. As you know, we are using what is called the Economic Policy Council for that purpose, with the subcabinet level group being the so-called Trade Policy Review Group.

And I don't really have any complaints with respect to the manner in which that is bringing about decisions, because I believe it is doing it quite well. There is no way to narrow an issue down to where one person at the Cabinet level makes these kinds of policy decisions. The President of the United States can make them, but no one Cabinet Member can do that, because there is the inevitable interest on the part of a lot of Cabinet Members no matter how this is structured, and we have to take that into consideration.

With respect to the progress in trade negotiations in the absence of fast-track authority, I happen to think that we can make progress in negotiations, substantial progress, whether or not fast-track authority is granted in 1987. I would prefer to have it in 1987, because at some point in time our negotiating partners are going to begin to say, "Should we really devote time, effort, energy, and manpower to this effort when we are unsure as to whether or not the United States is really serious?" It seems to me the sooner we can provide a positive signal in that direction, the better.

We were very instrumental in launching this whole process in Punta del Este, Uruguay, as you well know. We should be pleased as Americans about the results of that exercise, as Senator Bentsen indicated, because we have all of our agenda items on the list, and so we have an opportunity to deal with all these problems in the new Round. And certainly we should have the fast-track authority to make that process move.

Senator **Roth**. If I might just make one comment, and I see my time is up, I agree with you that trade is a matter of which many in government at the Cabinet level have to become involved. But my concern is that, for example in this Administration, and it has not been too unlike what has happened in the past, it took several years for it to be sorted out exactly who was responsible for what, and there have been great turf wars, and I don't think that has helped the trade picture.

I think what we need is the kind of organization as in monetary and other matters where you know who has primary responsibility, and that is what I seek.

Thank you, Mr. Chairman.

The **Chairman**. Senator Packwood?

Senator **Packwood**. No questions, Mr. Chairman.

The **Chairman**. Senator Baucus?

Senator **Baucus**. Thank you, Mr. Chairman.

Ambassador Yeutter, you have less than two years remaining.

Ambassador YEUTTER. That is correct.

Senator BAUCUS. What are your goals, precisely? That is, to what degree does the Administration have goals to narrow the overall trade deficit? To what degree does the Administration have goals to narrow the trade deficit with particular countries? What are the precise goals that this Administration would like to see accomplished by the end of this two-year period?

Ambassador YEUTTER. Well, let me answer it as best I can.

Senator BAUCUS. I ask that in the spirit, frankly, of cooperation. That is, what are your goals so that we in the Congress can work with you to help achieve them? I am assuming that your goals are to reduce those deficits and reduce them very significantly. Could you kind of sit back a little bit and just philosophically tell us what it is you are trying to accomplish in these two years and what we can do to help it? I don't want just rhetoric; I want what, precisely, can we do here?

Ambassador YEUTTER. I have thought about that a lot, Senator Baucus, because two years goes by in a hurry, and as a practical matter it is really less than two years, and we have a lot of things on our plate. We have to carefully delineate priorities, particularly within USTR during that period. We have done some soul-searching on that in recent weeks. I will give you as fast an answer as I can, in the interests of time.

First of all, with respect to the basic question of the trade deficit, obviously all of us, whether we are in the Executive Branch or the Legislative Branch, would like to see the trade deficit decline as much as possible in the next two years.

Senator BAUCUS. What does that mean? Twenty-five percent? Fifty percent? What is your goal?

Ambassador YEUTTER. That is a difficult question to answer, Senator Baucus. Obviously it would be nice to get it down to zero. But we have to be realistic, to recognize that that is not likely to happen in the next two years, and one of the reasons is because a great deal of this is not within the control of the Administration. The Administration doesn't make the appropriations decisions in this government; those are made over here. And the Administration doesn't make policy decisions for Germany and Japan and a lot of other countries.

Senator BAUCUS. Granted, they are difficult; but still, it would help us to know what your goals are. And granted that the Administration does not appropriate dollars—still, what are the goals? What is the program, and what are the goals for the remaining two years?

Ambassador YEUTTER. In terms of realistic goals, now, in contrast to the unrealistic goal of getting back to zero, my judgment is that realistically, assuming that we make Gramm-Rudman targets or something approximating those targets, and assuming that Secretary Baker and myself and others are successful in some of our discussions with our major trading partners, it seems to me that it would be realistic to expect that we could reduce the trade deficit by as much as $30–40 billion each year during the next two years. And if everything fell right, we could do better than that. But I would rather be conservative in those estimates.

Senator BAUCUS. Do you have goals? I am assuming you have goals.

Ambassador YEUTTER. Well, as I said, we can have either realistic or unrealistic goals. In my judgment, those are realistic ballpark figures, based upon likely actions here in the U.S. Congress and likely actions by our trading partners.

Senator BAUCUS. Are those not only goals in the abstract but goals that you as USTR are going to aggressively work toward and seek to accomplish?

Ambassador YEUTTER. Well, obviously we will do all we can. As I said, we can't control the voting process here on Capitol Hill, and we can't control decisions by other governments.

Senator BAUCUS. So, it is basically a $30-40 billion reduction in each of the next two years?

Ambassador YEUTTER. I believe that, based upon what I construe to be realistic assumptions, that is in the ballpark. If we get a different and better performance on the part of some of our trading partners, that could improve; if we do a better job of cutting into the federal budget deficit, that could improve still more.

Senator BAUCUS. A second related question—as to the Chairman's very accurate, I think, observation of, "Why should other countries want to change the rules of the game when they have a good deal?"—the question being: Where is the muscle? Where is the beef? Where is the leverage? You know, where is it? So that we can get the level playing field and the rules changed, and so forth. Where is the leverage? Where is the muscle? Where is the beef?

Ambassador YEUTTER. I think there is a great deal of leverage there, Senator Baucus, in that our trading partners have to be concerned with their continued access to this market. We have a lot of tools available to us that we would like to access here, and in a number of tools that relate to us in terms of our access elsewhere. Section 301 is one of those tools.

Senator BAUCUS. I see my time is up, or almost up. I would just suggest that, in addition to denying the access to American markets as a tool—that has a very definite cost to American consumers—that the Administration more creatively look for other tools.

I just think that this country has to elevate economic policy and trade policy up to foreign policy, as other countries do, certainly the Pacific Rim countries.

Ambassador YEUTTER. Yes.

Senator BAUCUS. And I think the Administration should therefore use some other kinds of foreign policy tools in addition to denying access, in order to have the leverage and the muscle that is necessary to get these countries to open up.

Ambassador YEUTTER. Well, as you know, philosophically, the denial of access is the last road that this Administration wants to travel. We would much rather travel other roads, market-opening roads, and we have been doing that. I happen to think we have been doing it pretty darned successfully. And we have had some additional opportunities to do it both bilaterally and multilaterally.

The CHAIRMAN. Thank you, gentlemen.

Senator Rockefeller?

Senator ROCKEFELLER. Thank you, Mr. Chairman.

I want to associate myself very strongly with the remarks of Chairman Bentsen with respect to this word "protectionism." I just think it is so unuseful in terms of the goal that you have, Mr. Ambassador. I mean, you want to cooperate with the Congress. I don't doubt that. Before you came in this morning, I said I thought that you and Secretary Baker were the two best people in trade in the Administration, in the country. But the use of the word "protectionism"—it is a word that the American people understand. It is a word that, as the American people understand better, they come to dislike even more. So therefore it is a powerful word.

Ambassador YEUTTER. Yes.

Senator ROCKEFELLER. But I do think that whether it is Harley Davidson or VRA's, import relief is used by the Administration, as the Chairman said, as something which is good. But then if a Democrat or a Republican Member of Congress suggests a bill, it is called "protectionist." I do not find that useful.

Ambassador Strauss was here, as you indicated earlier, and he said he had a lot of contact with the President He related that he would go in and say, "Mr. President"—you need to call Prime Minister Callahan" or "you need to call President so-and-so or Prime Minister so-and-so" and he would do it right on the spot. In other words, there was a lot of hands-on presidential participation in trade matters, where the President learned quickly and acted aggressively, according to Ambassador Strauss

I don't think that President Reagan has done that. I don't think that you have the kind of contact and the kind of response that you need from him. And that will occur with other Presidents, even though trade rises in importance, as people understand that job loss and trade are related and that what we have to do in this country is staggeringly important. Nevertheless, there must be an enormous level of frustration for us as VSTR. I know there is a level of frustration among your people, because I talk with them, There is a lack of lacky, a lack of a muscle, a lack of leverage.

We have a $400 billion market—we as Americans buying $400 billion of imported goods. I don't know why you don't seek more muscle. I understand you are part of the Administration. I think it must be enormously frustrating for you to go to the table and not to have anything more than section 301, which takes so long, of which there have only been relatively few in recent years, with very small dollar consequences.

Why is it that you have confidence that you can get other countries to change their patterns—other countries that, as Senator Baucus and Senator Bentsen said, are just beginning to discover that they really do have it going their way? Taiwan has a $50 billion surplus; why should they want to change that? They may change it in terms of investing in this country, but they are not going to change it in terms of their trade practices; why should they? Why don't you want more structural legal muscle as you go into negotiations as our Trade Representative?

Ambassador YEUTTER. Senator Rockefeller, I have two or three comments on that. First of all, attached to my testimony today is a summary of what we have done in the trade area over the last 20 months. I hope you will take the time to peruse it, because if there is any 20-month period in the history of this country that matches that, I would like you to quote it, because I don't believe that the number of accomplishments will have been matched in any other previous 20-month period by anybody, ever.

Senator ROCKEFELLER. Mr. Ambassador, with all due respect, let me just interrupt on that point. I know that I have had that said to me in many ways by many people, that there has never been such a magnificent two years in all of our history of trading relations.

Ambassador YEUTTER. Yes. Make your own evaluation; I won't make it for you. Look and read.

Senator ROCKEFELLER. Well, we are going straight down the tubes in terms of trade relations. I mean, it used to be, "Well, yes, steel was going to be a problem," and, "Coal was going to be a problem," and, "Machine tools were going to be a problem." But now it is much more than that—it is high tech, it is semiconductors, information. They are in a trade-deficit situation. Services—that was going to be the last resort, but they are getting clobbered by the Japanese.

I don't understand. We may have been more aggressive on Section 301, although I would say it is very modest. The result isn't affecting us, except poorly.

Ambassador YEUTTER. Senator Rockefeller, I have said over and over again before this Committee, and I will say it again now, that we cannot deal with a $170 billion deficit through trade legislation or through negotiations. Most economists, I believe, agree that probably 90 percent of that $170 billion is due to macroeconomic policies here and abroad.

Senator ROCKEFELLER. And I agree. I agree with that, and let us make that 75 percent, and so only 25 percent is yours.

Ambassador YEUTTER. That's right.

Senator ROCKEFELLER. Still, it is a lot of billions of dollars.

Ambassador YEUTTER. That is absolutely right, and it is important, and that is why we are working so hard at it.

But I happen to think we are doing a heck of a lot. If you think we should be doing more, please say so, and tell us what you think we should be doing that we are not now doing. I really believe our productivity has been enormously high.

But secondly, I wanted to comment before we run out of time on the question of getting personal involvement by the President of the United States.

First, it is a different situation than it was when Bob Strauss was here. Bob is a dear friend, and I am a great admirer of him, and I think he was an outstanding USTR. But we have five times as many issues on our plate today as Bob had when he was U.S. Trade Representative—five times.

Now, the President of the United States cannot get involved in all of those issues. We have got dozens of balls in the air, and it is just impossible unless he is going to devote all of his time to trade matters. You have got to delegate in government; you have been a governor, and you know this very well. You can't do everything yourself. We can't expect the President of the United States to make trade policy decisions in 50 different areas; that is why he's got me on board. Now, if I don't do it, then he ought to get another USTR, and I am perfectly happy to have him do that. But it seems to me that my responsibility is to try to do that job, and I think I am doing it as well as I possibly can. But I don't think my job is to run to him every five minutes and say, "Help me do something." If I need his help, that's fine. And he has been very, very supportive.

I really believe, if my count is correct, that in all of the trade issues that we have taken to him in the last 20 months since I have been here, there is only one that has been decided not in accordance with the recommendation of the USTR.

Senator ROCKEFELLER. Thank you, Mr. Chairman.

Senator MATSUNAGA. Senator Bradley?

Senator BRADLEY. Thank you very much, Mr. Chairman.

Mr. Ambassador, in negotiations, if you are in negotiations with Brazil, and you want to get a services agreement, you want to get more foreign investment, direct, et cetera, would it help you and give you additional leverage if you had, say, as a tool the right to provide debt relief and interest rate relief to the Brazilians in exchange for opening up their markets?

Ambassador YEUTTER. Well, I would answer that in the abstract, because obviously one has to look at the elements of a particular package in any negotiation. But in the abstract, one would say that the more items on the negotiating table, better. And I have said that of many negotiations in the past.

Senator BRADLEY. Do you feel the Brazilians would value interest and debt relief?

Ambassador YEUTTER. Well, I am sure they would value anything of benefit to them, Senator Bradley, no matter what the source might be.

Senator BRADLEY. Why would interest and debt relief be of value to the Brazilians?

Ambassador YEUTTER. Well, anything that would relieve their financial burdens would obviously make life easier for them as a government and as a country. Whether or not one should provide that relief is another question. Again, I am answering you in the abstract and not in the concrete.

Senator BRADLEY. Yes. You mean, they might buy more U.S. exports?

Ambassador YEUTTER. That is certainly theoretically possible. And I give you a theoretical answer without explicit trade-offs.

Senator BRADLEY. Or they might invest internally and get higher growth rates.

Ambassador YEUTTER. That is correct. But again, one must construe what the trade-offs for that might be.

Senator BRADLEY. Okay. How many people do you have working on the Canadian negotiations directly?

Ambassador YEUTTER. I can't tell you how many we have specifically assigned to the Canadian negotiations, Senator Bradley, but the answer is enough. We will do our part in that negotiation. There are a lot more working full-time in Canada, and I am prepared to accept the responsibility for having fewer on this side than on that side. We believe that it is not simply a matter of numbers. As in all other negotiations, Senator Bradley, we have the right to ask for assistance from other departments of government. We do that, will do that to a greater degree on this negotiation as we move closer to a conclusion. We will be effectively manned.

Senator **Bradley**. Could you provide for the Committee the number of people who are working, and how many in Commerce, how many out of USTR?

Ambassador **Yeutter**. Certainly. But I would add, parenthetically, Senator Bradley, that because this is an issue that has come up from time to time, we are just now beginning the very serious negotiating phase in that agreement. We have not needed a lot of people on that agreement until now.

Senator **Bradley**. That is why it would be helpful for us to know as you go forward.

Ambassador **Yeutter**. We will try to give you an estimate of what we will use in manpower as we move toward the conclusion, which we hope will be next Fall.

[The information follows:]

Question. Is the support for the Canadian Free Trade negotiations adequate?

Answer. Yes. We understand that the Canadians have an 80 person unit set up to conduct the negotiations; at USTR there are only three persons working full-time on the issue.

But they are backstopped, depending upon the particular issue, by about 25 additional USTR staff (GATT affairs—4, Industry&Services—8, Computer group—4, Trade Policy—3, Agriculture—3).

Unlike the Canadians, we're organized on an interagency basis. Commerce has about 9 individuals, Labor 7, Treasury 6, State 13, USDA 4, ITC 2. Another 10 come from such agencies as Transportation, Justice, the NSC, and our embassy in Ottawa. If at the end of the day there is an agreement, our interagency approach will have assured its support across the government. We won't have to go out and sell it to other agencies.

Overall, a substantial investment.

Senator **Bradley**. What do you say to those who argue that you are pursuing a rather risky strategy with the Canadians, in that you are kind of sitting back and waiting, and expecting major Canadian concessions as the clock ticks?

Ambassador **Yeutter**. Well, I don't wish to divulge U.S. negotiating strategy in a public forum. Let's just say that what we will do in that negotiation between now and September is what we believe to be in the best interests of the United States. We will let the Canadian negotiators take care of what is in the best interests of Canada.

Senator **Bradley**. One last question: In the new Trade Bill that most of this Committee supported, there is a section that relates to 301 that removes the President's discretion if you find unfair trade practice. Is this going to act as a deterrent, do you believe, to unfair foreign trade practices abroad, or is it going to push us toward trade wars?

Ambassador **Yeutter**. I am troubled by those kinds of provisions, Senator Bradley, because they are too inflexible. As a negotiator, I much prefer greater rather than lesser flexibility, because every negotiation is different, and one cannot legislate a mechanism that provides us the greatest possible leverage and advantage in a given negotiation.

Senator **Bradley**. But assuming that any negotiator wants to have the universe to be able to negotiate with, including debt and interest rate relief, but assuming the Congress or assuming elements of the Executive Branch narrow that, as you look at the possible things that could be in a Section 301, are you really that concerned about this aspect of the bill?

Ambassador **Yeutter**. Well, my universe, Senator Bradley, my preferred universe, would be no mandatory provisions at all. As a negotiator, that would be my clear preference.

Senator **Bradley**. But assuming you are going to have some mandatory, can you think of anything less onerous than this mandatory?

Ambassador **Yeutter**. Well, Mr. Strauss probably put it very well by saying, if it is a need to be mandatory, then let's not make it compulsory. There has to be wiggle room for a negotiator, and there has to be wiggle room for the President of the United States. If we take away the wiggle room, Senator Bradley, it seems to me that we only harm this country; we help the opposition, we don't advantage ourselves.

Let me give you one specific example—and I am sorry to use your additional time. The fact of the matter is we settled on terms very favorable to the United States a leather dispute with Japan about 14 months ago. If we had had a mandatory retaliation provision, we would not have achieved a settlement in that case. We just settled about two weeks ago on terms a lot better than what Senator Daschle believes—I heard his questions earlier this morning—a major dispute with the European Community, as you know. Had we had mandatory retaliation, we would never have settled that case. They are two examples already of what rigidities can do that would be very detrimental.

Senator **Bradley**. Thank you.

Senator **Matsunaga**. Senator Danforth, do you have any questions?

Senator **Danforth**. Yes, I do, Mr. Chairman.

Mr. Ambassador, here is my concern, that nothing really works. Take Japan, as obviously everybody's leading example of the trade problem. We believe that there is a problem with respect to leather. We work out an agreement. Does it help the leather industry? No.

We believe that Americans can make baseball bats, "Surely we can." We attempt to sell baseball bats in Japan, they shut out our baseball bats, we work on that problem for a long period of time, and we end up not selling very many baseball bats.

We focus not on specific sectors where we have problems but on general problems. We try to encourage the Japanese to expand their own economy and to consume more. They set up a little commission, the Miyazawa Commission, and they say, "Oh, we are going to study this matter, and we are going to try to work out something where we will consume more." And then the morning paper indicates that nothing happens as a result of the Miyazawa Report. We negotiate, we harangue, we cry, we sob, we plead, and nothing happens.

You and I have discussed many times the problem of silicon. We try to sell silicon; we can't sell silicon. We are told that maybe we should have a finishing plant in Japan, and we can sell silicon. We say, "Well, we don't need to have a finishing plant; it is just surplus." "Well, put in a finishing plant, anyhow." We put it in the district of the Trade Minister; still, no silicon is sold.

Now, I understand what you say about wiggle room. It just seems to me that we do a lot of wiggling and very little forward motion, and that very little really happens, and very little works.

The problem with Japan, just to single out one country—there are others that I think could be singled out, too—the problem is that, where there is a will in a country to keep out products from other countries, where there is a general principle of mercantilism that pervades the country, its private sector and its public sector, you negotiate down one barrier and, as soon as you have gotten that out of the way, you find five more have cropped up to take its place. So you start a whole new proceeding, and you get rid of that barrier, then you have got five more. And it is just treading water; it is spending an awful lot of energy treading water, unless there is a will in the other country to really do business fairly, and to give a fair opportunity to other countries to export into their markets.

Now, how is that will created? How is a will created in, say, Japan? What would do the job of saying to the Japanese, "Well, we want to do business; we want to be fair in trade?" Do they do it because they have had a change in heart? Do they do it because they have had some sort of religious experience? What is it that would induce a Japan to say, "Well, we will buy silicon" or "we will buy skis" or "we will buy baseball bats," or anything else? Why would they do that?

I think that the reason they would do it is because they believe that there is a down side in not doing it. If they were to believe that somehow it would not be in their self-interest to be protectionist themselves, if they believed that there was a down side in mercantilism, then maybe they would be more reasonable and open up their markets.

Now, why do I believe in retaliation, mandatory retaliation, almost automatic retaliation? Why? Because I think that a Japan has to feel that it is their choice. They might choose to keep out our beef or our silicon or our citrus—fine. Let them decide that. But that decision has to carry with it a down side; that decision has to trigger, automatically, something bad that happens to them. If they believe that they can simply keep out our products—our silicon, our baseball bats, our skis, whatever—if they believe they can just keep it out, and what that will trigger is a very lengthy process extending over months, perhaps years, which may or may not lead to some remedy, depending on the discretion of the President of the United States to say, "Well, we are not going to do anything," and which even if it leads somewhere leads to the elimination of one specific barrier when there are 10 other barriers behind it, then there is no credibility in the system.

Now, the reason I think we should rewrite the trade laws is not out of joy of retaliation. It doesn't make me feel good to retaliate. And I certainly don't believe that reciprocity should be a code word for protectionism. But what I do believe is that there must be penalties which are surely imposed on those who don't want to do business with the United States. And if we don't have such penalties, then I fear that nothing happens, that nothing works.

Senator MATSUNAGA. Senator Danforth, your time has expired, and it is almost 1:00. Does the Senator have a question—not a statement—but a question?

Senator **Danforth**. I appreciate your forbearance, Mr. Chairman, and if you would like to go to lunch I will be happy to stay. [Laughter.]

Senator **Matsunaga**. No, I am thinking of the witness, Senator.

Senator **Danforth**. Oh, he is doing all right. [Laughter.] He needs to skip lunch, anyway.

No, you understand the point, Mr. Yeutter, and you understand what I am driving at.

Ambassador **Yeutter**. Yes.

Senator **Danforth**. And I would welcome any response that you would care to make.

Ambassador **Yeutter**. Yes. Thank you, Senator Danforth. I understand full well the point you are making. Two or three comments:

The first would be that I think your earlier assessment that nothing works is too glum. Certainly not everything works, because we live in an imperfect world, and I would surmise that it will still be an imperfect world 500 years from now or 1000 years from now. That's life. What each of us attempts to do here, of course, is make it a little more perfect while we are here, if we can.

Second, I would say—and this goes back to Senator Rockefeller's earlier comment about frustrations—I can't speak for everybody else in USTR but, insofar as I am concerned, I am not at all frustrated, Senator Rockefeller, with any of our trade relationships around the world, country-by-country, with possibly one or two exceptions, and one of those is Japan. And I have given that one a great deal of thought over the last 20 months, just as you have, Senator Danforth, because we have both struggled with it, both in terms of what our macroeconomic policy responses should be to that country and what our more micro-responses in the trade negotiating arena should be. I am not satisfied that any of us yet have the right answers there.

I noted from the paper this morning, too, that even Mr. Miyazawa was critical of his associates in Japan for the way they are conducting their economic policies.

With respect to the export side—that is, Japanese products flowing into the United States—I am convinced that we are about to see alterations in those patterns as the result of the exchange rate adjustment process. That is notwithstanding the fact that many of those companies have absorbed the exchange rate differential for a long time. That cannot be done forever, and there is no doubt that there is considerable stress in the Japanese export arena at the moment. That is as it should be, when one has a gigantic global trade surplus, and in this case also a gigantic bilateral surplus.

So, I am anticipating an adjustment on the export side. I am much more concerned, however, about the other side of that coin, which is American products flowing into Japan, because we are not yet seeing a turnaround in that situation, notwithstanding a very major move in exchange rates. And neither is anyone else, for that matter, because Japan's imports in 1986, in yen terms—and these are numbers I just happened to look at yesterday—are down 30 percent. And I find it inexplicable to see imports off 30 percent in 1986 going into Japan, at a time that Japan is running a very, very large global trade surplus, perhaps the largest in the world.

That says to me that the mind set that has been there for centuries has not adjusted very much until now.

Now, what is the response to that? That gets into your issue as to whether mandatory retaliation is the way to deal with that issue.

I guess where I would come down, Senator Danforth, is that I think we ought to have retaliation, but mandatory retaliation is too big a price to pay in rigidity and inflexibility.

I understand your argument fully, but I would still prefer not to go down that road, because it seems to me it could come back to haunt us, not only in Japan but in a lot of other areas.

But we do have to be prepared to use the retaliatory weapon, without a shadow of a doubt. As you know, we successfully opened up the Japanese tobacco products market just two or three months ago. I am convinced that we would not have done so had we not been prepared to retaliate in that case. And as you know, we had the retaliatory papers on the way to President Reagan at the time we settled that dispute. That one should be worth $1 billion a year, or thereabouts, in American exports. So, it is worth doing, and it is part of the listing of successes that I was quoting to Senator Rockefeller earlier.

But as you say, Senator Danforth, with a $50-plus billion trade deficit with Japan, we need a lot of those billion-dollar success stories if we are going to move back to equilibrium, unless we get the kind of response on the macroeconomic policy front that Senator Bradley was talking about. And so far, we have not seen much generation of domestic demand in Japan.

Senator MATSUNAGA. Mr. Ambassador, first of all I want to congratulate you and commend you for your aggressive use of Section 301 and for your recent accomplishments, particularly I refer specifically to your negotiating a $400-million payment from the European Community.

Ambassador YEUTTER. Thank you.

Senator MATSUNAGA. Of course there are many other examples of the use of Section 301 since you have taken over, and I congratulate you.

Time of course is already limited, and everyone is leaving now. [Laughter.]

Ambassador YEUTTER. We are going to have a two-person hearing, Senator Matsunaga.

Senator MATSUNAGA. I am already late for another engagement. So, I will ask you to list the provisions to which you object most in the Omnibus Trade Bill of 1987 S. 490 which we have introduced, as you know, with 54 cosponsors.

Ambassador YEUTTER. Yes.

Senator MATSUNAGA. I think you should bear in mind that, although there are 54 cosponsors to the measure, not all of us agree to all provisions of the Omnibus Bill.

Ambassador YEUTTER. Yes.

Senator MATSUNAGA. So, you may find members who agree with you, in your opposition to certain provisions.

I think Senator Baucus brought up a matter which I had in mind myself. It would help us tremendously if you would submit to us in writing your list of negotiating objectives and how you intend to accomplish those objectives. I think that would help tremendously.

And with those words, I will now adjourn the Committee's meeting.

Ambassador **Yeutter**. Okay. Thank you, Senator Matsunaga.

[Whereupon, at 1:05 p.m., the hearing was adjourned.]

[By direction of the chairman the following communications were made a part of the hearing record:]

STATEMENT SUBMITTED FOR THE RECORD
BY ELISSA MATULIS MYERS, CAE,
DIRECTOR OF INTERNATIONAL ACTIVITIES FOR THE
AMERICAN SOCIETY OF ASSOCIATION EXECUTIVES
BEFORE UNITED STATES SENATE COMMITTEE ON FINANCE,
HEARINGS ON "MASTERING THE WORLD ECONOMY"

The American Society of Association Executives ("ASAE") submits this statement to the Senate Committee on Finance for its consideration in structuring legislation to develop an open international trading system, improve the United States export position and competitiveness on an international level, and to correct current trade imbalances. The mission of the statement is to bring to the attention of the members of the Committee the valuable role trade and professional associations can play in furtherance of these goals, particularly in the long term.

ASAE represents over 14,000 executives from about 7,000 trade and professional associations and societies in the United States and abroad. ASAE was founded in 1920 and takes pride in its continuing representation of the association community in the United States, within a body of 80 million association members. Recently, ASAE founded an International Section to reflect the growing interest of its members and their associations in a variety of issues of international significance. This International Section has grown rapidly and illustrates the growing importance of the international ties of U.S. business and associations throughout the world.

ASAE believes trade and professional associations offer a valuable service to the country and to the international economic environment in a number of ways. Such trade and professional associations have the knowledge, expertise, staff, and broad-based volunteer support necessary to fill a major role between that of the Government and private enterprise. In representing groups of competitors, ASAE also represents the leaders of every field, who are constantly striving to improve their profession or industry. Associations from other countries are becoming increasingly involved with U.S. trade and professional associations, offering new avenues of communication with foreign market participants. Associations can help in the long run to structure a new, open international trading system.

ASAE would like to join in support of the many efforts being undertaken in the United States to improve the nation's competitiveness. We are aware of initiatives in the Congress, such as the bypartisan Competitiveness Caucus, and also those being made by the Administration, as indicated in the President's recently announced Competitiveness Initiative. We offer our services to support such initiatives and help generate a new era of U.S. competitiveness and leadership in the World Economy. Given the broad cross-section of interests and industries represented by ASAE, we welcome the challenge to further educate and involve association executives in the interest of an efficient and mutually productive international trading environment.

ASAE recognizes that a growing number of its members, and the members of the associations they represent, are from outside the United States. We believe that support for legislation aimed at improving U.S. competitiveness will benefit the international economic environment in the long term, thereby being in the interests of associations from all nations. Indeed, in spite of short term trade problems caused in part by the emergence of newly developing and industrialized countries, ASAE believes there is much room, in fact, that it is necessary, for increased multilateral cooperation and communication among the professional and industrial sectors of nations in the world market. ASAE feels that its growing internationalism, together with the inherent value of cooperation among competitors typified by associations, can be another tool in the development of the World Economy.

Although the association community is only beginning to exert influence on an international level, and many aspects of the type of services that associations could provide are still hazy, we offer the following suggestions to the Committee with aspirations that the role of associations in the international trade arena will be accepted, encouraged, and amplified. Further, ASAE hopes such services can assist in the enhancement of U.S. exports of products, knowledge, and services.

ASAE believes the following opportunities exist for involvement by associations in the international trade arena:

-- Associations can help in specifically encouraging exports through Export Trading Companies, pursuant to the Export Trading Company Act of 1982. Many associations have considered this type of activity, but many also have been wary of the risks involved. The involvement of banks being a crucial factor in many export trading companies, improvements to the current Act may be desirable. Additionally, specific recognition and provisions could be made adaptable to association involvement, thereby encouraging a vast segment of the American economy to become more export-oriented under Export Trading Companies.

-- Associations have traditionally helped sponsor research programs, but fears of unwarranted antitrust liability loom large over such efforts. The Congress has recognized that research and development activities on a joint venture basis are essential to improving U.S. competitiveness by its action in enacting the National Cooperative Research Act. This Act could be strengthened by providing for the active involvement of associations and offering more substantive antitrust protections attuned to today's real world need.

-- Associations have traditionally sponsored educational programs for their members in a wide range of topics in virtually every profession and industry. In fact, an integral part of ASAE's own mission is to provide associations and association leaders with better tools for meeting and fulfilling that obligation. Association sponsored seminars and programs include many of those noted in the President's Competitiveness Initiative as necessary to promote long term U.S. excellence in trade. With more emphasis on educational programs directed at export seminars and forums, Congress should encourage associations to fill this educational role to the maximum. Encouraging the relevant Government agencies and departments to seek association assistance in sponsoring such programs would improve exports and enhance other factors of competitiveness, furthering efforts to reduce the trade deficit, especially in the long run.

-- Associations are seeking greater opportunities for involvement in communications with their association counterparts in other countries, including promotion of international arbitration for the settlement of country-to-country and industry-to-industry disputes. The role of associations in offering such opportunities has been largely overlooked. We need to offer the association community's support for substantive backing of the U.S. Government in this regard.

-- The international networks arising worldwide between and through associations provide opportunities for marketing information to be readily transmitted, thereby creating an environment more conducive to exporting. Recognizing that this connection can work both ways, we feel confident that American competitiveness will advance and prevail in the long term, and benefit from such exchange of information.

-- Associations can also be a source for a wide variety of services. For instance, the Federal Bar Association, in conjunction with the U.S. & Foreign Commercial Service of the Department of Commerce, recently instituted a program offering free legal counsel to U.S. exporters. This type of cooperative program could be duplicated in many professions, including engineering, accounting, and scientific areas, to further enhance the U.S. export position.

-- ASAE also recommends that the Congress give consideration to the impact of the present antitrust laws on international competitiveness. We do not suggest weakening provisions where such laws are truly supportive of the free enterprise system, but that Congress tailor the antitrust laws so as not to hinder U.S. international competitiveness. This would apply to both domestic actions and foreign actions subject to the antitrust laws, where the reach of such laws is often not clear.

-- Associations collectively comprise the most comprehensive information networks among individuals and businesses in the country. The cumulative effect of information sharing by and among association members can only contribute to improved economic performance. The sharing of such data with an emphasis on export enhancement should be encouraged.

-- Finally, as suggested in the previous point, association communication links can be extremely valuable in supplementing Government policy with association members. Almost 90% of the companies in America that can export, do not. Given the cooperation of Government departments and agencies, associations can provide information on exporting to its members that will help alleviate the fear of entering foreign markets. One of the most important services the association community can provide is to assist in the information flow that encourages an export frame of mind and reduces fears of going beyond U.S. boundaries.

We hope the Committee will take our ideas into account in formulating trade legislation. ASAE will be pleased to work with the Committee and its staff in taking whatever steps are necessary to assist in implementing these ideas. We also extend to you our ability and that of our members to provide any information that you may deem pertinent. We hope we can work together to engage the association community in the international economic arena to encourage U.S. export competitiveness, and foster continued improvement in the world economic picture.

MICHIGAN STATE UNIVERSITY

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February 4, 1987

William J. Wilkins, Esq.
Staff Director and Chief Counsel
United States Senate Committee on Finance
Room SD-205
Dirksen Senate Office Building
Washington, DC 20510

Dear Mr. Wilkins:

Since it was not possible for us to present testimony in person, Professor James W. Brock (Miami University, Ohio) and I respectfully request that the enclosed article from the Nebraska Law Reveiw be included in the printed record of your hearings, "Mastering the World Economy."

In our recently published book, The Bigness Complex, (Pantheon, 1986), Professor Brock and I analyze a variety of proposals to make American industry more competitive in world markets. Among these, we believe that the currently fashionable proposal to weaken (or repeal) the antitrust laws is perhaps the most dangerous. In particular, we believe that it is both unwise and counterproductive for the Administration to tolerate (and often encourage) megamergers in the mistaken belief that large corporate size is the handmaiden of production efficiency, technological progress, and international competitiveness. If protection of our domestic markets and penetration of foreign markets is our national objective, "liberalization" of the anti-merger laws now on the books is not the proper means to that end.

The enclosed article briefly summarizes our position. We respectfully submit that its inclusion in your printed hearing volume will contribute to informed discussion of the public policy issues pending before your Committee.

Faithfully yours,

Walter Adams

Walter Adams
Distinguished University Professor
and Past President

WA/gt

enclosure

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NEBRASKA LAW REVIEW
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Walter Adams*
James W. Brock**

The Proposed Emasculation of Section 7 of the Clayton Act

The Reagan Administration's recent legislative proposals for antitrust reform would, if enacted by Congress, mark an historic reversal of the nation's anti-merger policy. They would significantly relax extant statutory prohibitions against potentially anticompetitive mergers and acquisitions. They also would empower the President to grant relief to import-impacted industries by "temporarily" exempting them from the anti-merger laws. The Administration's rationale seems to be that past merger policies are responsible for the declining international competitiveness of American firms, and that those policies have deprived American industries of the ability to restructure themselves in order to achieve (or regain) world-class competitive status.

POSTULATES UNDERLYING THE "MODERNIZED" SECTION 7 OF THE CLAYTON ACT

Unfortunately, these proposed revisions are based on six postulates which are asserted with axiomatic confidence, but which lack empirical support.

First, the Administration believes that overzealous anti-merger enforcement has prevented American companies from engaging in mergers and acquisitions. This is incongruent with the facts: Megamerger mania has engulfed American industry since the 1970s. Between 1970 and 1984, some 44,200 mergers and acquisitions were consummated in the United States. In 1984 alone, mergers and acquisitions totalled 2,543. The total value of all U.S. acquisitions reached an all-time record high of $82.6 billion in 1981, and established new records of $122.2 billion in 1984, and $179.6 billion in 1985.[1] The very largest corporations in the country have been in the forefront of the merger wave, not only acquiring "small" and "medium-sized" companies, but—increasingly—combining with one another (including such recent consolidations as DuPont/Conoco; U.S. Steel/Marathon Oil; Chevron/Gulf; Texaco/Getty Oil; Allied/Bendix/Signal; Standard Brands/Nabisco/R.J. Reynolds; General Electric/RCA; Occidental Petroleum/Iowa Beef Processors/Cities Service/Midcon; General Motors/EDS/Hughes).

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[1] W.T. Grimm & Co., MERGERSTAT REV. 1984, at 6; Vartan, *New Climate for Mergers*, N.Y. Times, Mar. 13, 1986, at D10, col. 2.

Moreover, a myriad of quasi-consolidations, or "joint ventures," have been countenanced, notably between the American auto oligopoly and its foreign rivals (e.g., GM/Toyota; GM/Daewoo; GM/Isuzu; GM/Suzuki; GM/Lotus; Ford/Mazda; Ford/Mazda/Kia; Chrysler/Mitsubishi; Chrysler/Mitsubishi/Hyundai; Chrysler/Samsung; and Chrysler/Maserati). Indeed, according to one count, the Justice Department has challenged but 26 of the approximately 10,000 merger applications filed with it during the 1980s.[2] At the same time, Justice has since 1981 sanctioned 75 of the 100 largest mergers in American history—hardly a record of "burdensome" or "overzealous" antitrust enforcement.[3]

Second, the Reagan Administration uncritically accepts the "new learning" that megamergers are the touchstone for enhanced production efficiency, technological innovation, and world-class competitiveness. Yet, objective empirical research casts considerable doubt on this currently fashionable belief. In one exhaustive study of the statistical evidence regarding conglomerate mergers, Dennis C. Mueller reports "a surprisingly consistent picture. Whatever the stated or unstated goals of managers are, the [conglomerate] mergers they have consummated have on average . . . *not* resulted in increased economic efficiency."[4] Mueller reports similar findings in an updated econometric study expanded to include all varieties of mergers— horizontal and vertical, as well as conglomerate.[5] Other careful researchers reach similar conclusions.[6] Moreover, the high post-merger divorce rate—up to forty percent of the 1970's acquisitions, according to W.T. Grimm and Co.—is further evidence that the efficiency-through-merger hypothesis is a dubious basis for formulating public policy.

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[2] Solomon, *Administration Hopes to Extend the Reagan Revolution to Antitrust Laws*, Nat'l J., Jan. 18, 1986, at 144.

[3] W.T. Grimm & Co., *supra* note 1, at 24-28. For a detailed analysis of large corporate acquisitions, see W. Mueller, The Celler-Kefauver Act: The First 27 Years, Study for the House Subcomm. on Monopolies and Commercial Law, 96th Cong., 1st Sess. (1980). On the anticompetitive problems posed by joint ventures, see Adams & Brock, *The "New Learning" and the Euthanasia of Antitrust*, 74 Calif. L. Rev. (forthcoming 1986).

[4] Mueller, *The Effects of Conglomerate Mergers: A Survey of the Empirical Evidence*, 1 J. Banking & Fin. 344 (1977) (emphasis added).

[5] Mueller, *Mergers and Market Share*, 67 Rev. Econ. & Statistics 259 (1985).

[6] *See, e.g.*, F. Scherer, Industrial Market Structure and Economic Performance 138-41 (2nd ed. 1980); Scherer, *Takeovers: Present and Future Dangers*, Brookings Rev., Winter/Spring 1986, at 15-20; S. Rhoades, Power, Empire Building, and Mergers, esp. 89-118 (1983). For a compendium of studies on the failure of mergers to enhance economic performance, see Adams & Brock, *supra* note 3.

Nor do megamergers seem conducive to technological innovation. According to one analyst, the "vast majority of acquisitions of high-technology companies by large corporations [including acquisitions by Exxon, Buroughs, 3M, and Westinghouse] have ended in disaster."[7] An important reason, *The Wall Street Journal* reports, is that the "giants' many layers of bureaucracy often paralyze the freewheeling entrepreneurial style typical in the high-tech world."[8] Conversely, managers of divested operations released from control by corporate giants are "freed from endless hours of explaining proposals to corporate headquarters and waiting months, often years, for approvals on new projects . . . ."[9] Although the Administration seems incognizant of this reality, a spate of recent articles in prominent business periodicals has documented the creative backwardness of Bigness.[10] As Martin S. Davis, president of Gulf & Western, recently confided to *Business Week*: "Bigness is not a sign of strength. In fact, just the opposite is true."[11]

Third, the Reagan Administration believes that exempting import-impacted U.S. industries from the antitrust laws, and permitting them to freely merge, will cure the malaise of such industries as steel and autos, and bolster their ability to compete against imports. This assertion is flawed, not only because (as has just been argued) megamergers seldom contribute to improved economic performance. Beyond this, it ignores the fact that the import "problem" suffered by many major American industries is typically the result of oligopoloid giantism and noncompetitive industry structures *at home*—industry structures that have bred cost inefficiency, poor productivity, lethargic innovation, and, most generally, the bureaucratic dry-rot of unchallenged oligopoly power.[12] Indeed, if mammoth size and especially merger-induced giantism were truly conducive to world-class competitiveness, the

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[7] Cohen, *Failed Marriages*, Wall St. J., Sept. 10, 1984, at 1, col. 6.

[8] *Id.*

[9] Wayne, *Joys of Fleeing the Corporate Stable*, N.Y. Times, Nov. 15, 1981, § 3, at 1, col. 4 & 26, col. 1.

[10] *See, e.g.*, *Big Goes Bust*, ECONOMIST, Apr. 17, 1982, at 67; *Small is Beautiful Now in Manufacturing*, BUS. WK., Oct. 22, 1984, at 152; Prokesch & Powell, *Do Mergers Really Work? Not Very Often—Which Raises Questions About Merger Mania*, BUS. WK., June 3, 1985, at 88; Pittel, *Smaller Can Be Prettier*, FORBES, June 17, 1985, at 206.

[11] Dobrzynski, *Splitting Up: The Other Side of Merger Mania*, BUS. WK., July 1, 1985, at 50, 53.

[12] *See* W. ADAMS & J. BROCK, THE BIGNESS COMPLEX (forthcoming from Pantheon Books 1986).

American steel and automobile oligopolies should be the efficiency and innovation marvels of the world. Clearly, they are not.

General Motors is the world's largest auto company. Its dollar sales are roughly equivalent to the *combined* sales of nine Japanese auto makers. The sales of GM and Ford equal the *combined* sales of twelve leading foreign auto companies—the three largest in Japan, Germany, France, and Great Britain, respectively. Even Chrysler is bigger than all but two of the Japanese producers. Can it really be argued that the U.S.A.'s Big Three are too small to be efficient, or that massive mergers and joint ventures are imperative to make them competitive in world markets? Certainly, if bigness were truly the guarantor of efficiency, GM would not find it necessary to enter into joint ventures with foreign companies (e.g., Toyota, Daewoo, *et. al.*) in order to learn how to produce cars economically.

As for steel, it is clear that firm size (as distinct from plant size) is not the problem of our major integrated producers. They dwarf not only many of their foreign competitors, but also the domestic minimills that have captured increasing shares of the U.S. market. It is equally clear that merger-induced giantism, consummated over three quarters of a century,[13] has not infused the steel oligopoly with an *elan vital*. Merging two major steel companies saddled with antiquated, inefficient facilities—LTV and Youngstown in the mid-1970s, and LTV and Republic in the mid-1980s—does not solve the efficiency problem. Combining two losers does not make a winner. If the objective is to become competitive in world markets—to compete successfully against Japan—what is needed are new, modern, state-of-the-art plants that are cost-effective. Mergers are not the means to that end.

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[13] The merger and acquisition record in American steel is instructive, especially in the light of the industry's less than stellar performance in recent decades. The formation of the steel oligopoly dates back to the founding of U.S. Steel in 1901—the "consolidation of consolidations" which combined 180 formerly independent plants and which captured control of 65% of the American steel industry. Bethlehem Steel was incorporated in 1904 as a combination of 10 producers; subsequently, between 1916 and 1945, it acquired 33 other firms. Other members of the oligopoly fraternity also grew largely by merger and acquisition. *See* FEDERAL TRADE COMMISSION, THE MERGER MOVEMENT, A SUMMARY REPORT, app. I (1948); *Steel—Acquisitions, Mergers, and Expansion of 12 Major Companies, 1900-1950*, Hearings Before House Select Comm. on Small Business, 81st Cong., 2d sess., 1950.

The urge to merge among the steel giants has continued— uninterrupted—to the present day. In 1968, Wheeling Steel (the industry's 10th largest) merged with Pittsburgh Steel (the 16th largest). In 1971, National Steel (4th largest) acquired Granite City Steel (13th largest). In 1978, Jones & Laughlin (the 7th largest) was merged with Youngstown Sheet & Tube (the 8th largest). And, in 1983, LTV (owner of the combined Youngstown and Jones & Laughlin operations) acquired Republic Steel, thereby rendering LTV the 2nd largest producer in the industry.

Clearly, antitrust has not interfered with this restructuring of the industry via merger. Equally clearly, this restructuring has done little, if anything, to cure the industry's chronic malaise.

Indeed, it is notable that in the one instance when antitrust action blocked a major merger—*United States v. Bethlehem Steel*[14]—the performance effects were singularly positive. Bethlehem proceeded to do what it had persistently pleaded was unfeasible: it constructed a giant, state-of-the-art facility at Burns Harbor, Indiana—"the only integrated green-field blast furnace oxygen converter rolling mill complex built during the 1960s and 1970s to provide a U.S. counterpart to the modern steel-making capacity growing by leaps and bounds abroad."[15] In sum, a dispassionate review of steel history from 1901 to the present yields at least three incontrovertible conclusions: a permissive merger policy promotes neither efficiency nor technological innovativeness; progressive consolidation of already overconcentrated industries may only exacerbate oligopolistic behavior and, therefore, invite a perpetuation of delinquent performance; and antitrust action against mergers in these industries often promotes, rather than diminishes, the prospects for enhanced economic performance and international competitiveness.

Fourth, the Reagan Administration posits that foreign competition renders domestic industry structure irrelevant, and obviates the anticompetitive consequences of mergers in import-sensitive industries. But this postulate, too, is erroneous. It ignores the well-documented reality that giant international rivals recognize that their mutual self-interest lies in cooperation and collusion, *not* hard competition; and, further, that concentration of domestic industries enhances the fruits, means, and incentives for forging global market control. As Sir Alfred Mond, organizer of ICI, the giant British chemical combine, pointed out long ago, "You cannot discuss big problems of industry with other countries until your own industries are organized first."[16] Or, as Corwin D. Edwards has explained: "Unless domestic business enterprises effectively control the market in each country. . .international [market control] becomes impossible because of the certainty of local competition sufficient to nullify cartel policies."[17] Viewed in this light, domestic consolidation may *not* portend more vigorous international rivalry (as the Administration presumes). Instead, it may well mark an important first step toward transnational oligopolization, a concomitant diminution of competition, and a return to the global market controls—cartels, joint ventures, transnational mergers, and mutually agreed upon spheres of influence—of the inter-war years.[18]

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[14] 168 F. Supp. 576 (S.D.N.Y. 1958).

[15] F. SCHERER, *supra* note 6, at 546.

[16] Quoted in C. EDWARDS, ECONOMIC AND POLITICAL ASPECTS OF INTERNATIONAL CARTELS, Study for Senate Subcomm. on War Mobilization, 78th Cong., 2d Sess. 2 (1946).

[17] *Id.* at 1-2.

Fifth, the Administration bases its proposals on the belief that the only anti-social problem posed by mergers is a capacity on the part of the merged firms to affect price in some "relevant" market. Absent such influence, Administration policy-makers seem to believe, mergers and acquisitions are unobjectionable, regardless of how large the combining firms may be. In reality, however, this is a profoundly naive conception of the politico-economic consequences of Bigness and power. The Bigness Complex in autos illustrates the point: When Chrysler (then the nation's tenth largest industrial concern) confronted bankruptcy in 1978-79 as the result of poor performance, it did not passively submit to the rules of the competitive market game. Instead, the firm—joined by the United Auto Workers, as well as by suppliers, subcontractors, governors and mayors, senators and representatives, Republicans and Democrats—mobilized the power of giantism to manipulate the state and obtain a federal bailout. In 1981, when the entire domestic oligopoly confronted the competition of Japanese imports (after having ignored the market for decades), the Bigness Complex in autos—companies and the Union—engineered a bailout of the whole industry from global competition through governmentally-negotiated "voluntary" Japanese export restraints. In 1985, GM and Ford seized upon the power of size, and obtained a relaxation of government fuel economy standards, by threatening economic sabotage on a grand scale—plant closings, shutdowns, layoffs and unemployment—should their demands be denied. Alas, Brobdingnagian size permits privileged firms and industries to demand—and, more often than not, to obtain—tax favors, dispensations, governmentally-subsidized loans, governmentally-subsidized services, and tax holidays from states and communities across the country. In a representative democracy, the power of giantism is not limited solely to the ability to influence price in an isolated "relevant" market; it encompasses the far more ominous capacity to manipulate the state to anti-social ends. Not the least threatening of these are government protection from foreign competition and federal bailouts—outcomes which the Administration purportedly seeks to avoid, but which merger-induced giantism renders more feasible and more difficult to resist.[19]

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[18] The vast, extensively-documented network of global market controls erected during the decades preceding World War II belies the Administration's faith in the immutability of international competition.

In chemicals, for example, the world's largest producers, capped by the "Grand Alliance" between DuPont in the U.S., Imperial Chemical Industries (ICI) in Great Britain, and IG Farben in Germany, "set up their private controls. They divided markets; they marked off industrial fields; they established export quotas; they exploited specified fields and markets cooperatively. Joint control of the market became the general rule; free competition, the exception." G. STOCKING & M. WATKINS, CARTELS IN ACTION 418 (1946). According to Stocking and Watkins' classic study, global chemical cartel controls embraced far more than a seemingly inexhaustible number of particular products. More broadly, they encompassed "a whole series of tangible and intangible [intercompany] relationships, nebulous and specific arrangements, amorphous and settled conventions . . . which have had a real and potent influence in shaping the development of the world's chemical industries and in regulating chemical markets . . . ." *Id.* at 419. "By informal understandings, international alliances, communities of financial interest, joint enterprises and 'patents and processes' agreements, all woven into a coherent pattern, they . . . established 'orderly' markets for chemicals, abated competitive risks, and maintained a high rate of profits." *Id.* at 11. For these chemical giants, the outbreak of war was a temporary disruption; their "general understanding was that they would take up again at the close of the war where they had left off, in an atmosphere of mutual concord and cooperation." *Id.* at 423.

The chemical industry was not unique in this regard, however. Global cartel agreements between the world's leading producers controlled international trade in a large number of fields, including petroleum, steel, aluminum, light bulbs, and magnesium. Indeed, at the outbreak of World War II, a Justice Department study found 179 world cartels to be in operation, with American companies participating in 109 of them. *See* Adams & Brock, *supra* note 3 and sources cited therein.

Sixth, Administration policymakers assume that, at worst, mergers are merely benign. After all, they seem to reason, if a merger fails to produce better economic performance, the combination will be undone, the acquired operations divested, and society will be none the worse for it. However, this ignores the key economic principle of "opportunity cost" and its most important corollary, that there is no such thing as a free lunch (a proverbial truth that this Administration should be expected to embrace). Thus, two decades of managerial energies devoted to sterile paper entrepreneurialism and the quick-growth-through-merger game are, at the same time, two decades during which management attention has been diverted from the critical task of investing in *new* plants, *new* products, and state-of-the-art manufacturing techniques. Billions of dollars spent on shuffling ownership shares are, at the same time, billions of dollars *not* spent on productivity-enhancing plant, equipment, and research and development. The millions of dollars absorbed in legal fees and investment banking commissions are, at the same time, millions of dollars *not* plowed directly into the nation's industrial base. The opportunity costs of merger mania are real. And they bode ill for the reindustrialization of America.[20]

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19. For an elaboration of the broader political economic problems posed by Bigness and corporate giantism, see Adams & Brock, *Corporate Power and Economic Sabotage*, 20 J. ECON. ISSUES __ (forthcoming 1986) and Adams & Brock, *Bigness and Social Efficiency: A Case Study of the U.S. Auto Industry*, in CORPORATIONS AND SOCIETY: POWER AND RESPONSIBILITY (W. Samuels & A. Miller, eds.) (forthcoming from Greenwood Press 1987).

20. The following 1983 expenditures reveal the current priorities of U.S. corporations and the concomitant "opportunity cost" burden to the nation:

THE LANGUAGE OF THE "MODERNIZED" SECTION 7

Aside from the infirmity of the postulates on which it is based, the Merger Modernization Act of 1986 is a thinly veiled attempt at outright repeal of Section 7. The Act would replace the prohibition of mergers where "the effect . . . *may* be substantially to *lessen competition*, or to *tend* to create a monopoly"[21] with a prohibition of only those mergers where "there is a significant probability" that a merger "*will* increase the ability to exercise *market power*."[22] It defines market power as "the ability of one or more firms profitably to maintain prices above competitive levels for a significant period of time."[23]

Stripped of persiflage, this change in the law's language raises the threshold for illegal mergers from a "lessening of competition" to a "creation of monopoly" standard. It would, in effect, permit all mergers except those unlawful under Section 2 of the Sherman Act. The Act would, therefore, emasculate the existing Section 7 which was specifically designed to strike at merger-induced accumulations of power in their incipiency—i.e., *before* they reached monopoly proportions. It would repeal the rule, articulated by Chief Justice Warren in *Brown Shoe*, that Sherman Act (i.e. monopoly) standards were *not* to be used in judging the legality of mergers under the Clayton Act.[24] It would transform the anti-merger law into an anti-monopoly law.

Lest this new *monopoly* statute be enforced with undue stringency, the Act also instructs the courts to "duly consider all economic factors relevant to the effect of the acquisition in the affected markets."[25] A

Mergers & acquisitions:	$122 billion
Net private domestic investment (nonresidential):	107 billion
Privately-financed corporate research & development:	49 billion

Sources: ECONOMIC REPORT OF THE PRESIDENT, 250 (1985); DEP'T OF COMMERCE, STATISTICAL ABSTRACT OF THE UNITED STATES, 574 (1985); W.T. Grimm & Co., *supra* note 1, at 6.

Obviously, the expenditures on mergers and acquisitions are exceeding both the investment in new plant and equipment, and dwarfing—by a margin of 2.5 to 1—the funds devoted to research and development.

Nor are "tax incentives" a likely remedy for this imbalance. As the Citizens for Tax Justice found, "companies that paid no tax between 1981 and 1984 cut investment by four percent, cut employment by six percent, and cut exports by 15 percent—even as they embarked on a spree of mergers and higher dividend payouts and raised their top executive salaries by 52 percent." McIntyre, *Get on Board*, NEW REPUBLIC, June 2, 1986, at 14, 16.

[21] Clayton Act § 7, 15 U.S.C. § 18 (1976) (emphasis added).

[22] S. 2160, 99th Cong., 2d Sess., *reprinted in* TRADE REG. REP. (CCH) No. 744, Part II, Feb. 24, 1986, at 8 (emphasis added) [hereinafter cited as Senate Merger Bill]. The bill has been introduced in Congress as the Merger Modernization Act of 1986.

[23] *Id.*

[24] Brown Shoe v. United States, 370 U.S. 294, 328-29 (1962).

[25] Senate Merger Bill, *supra* note 22, at 9.

cynic might observe that the specifically enumerated factors plus the catch-all "any other evidence" category constitute convenient loopholes which, if interpreted in the light of the "new learning" (Chicago School) economics, would permit most megamergers to survive antitrust scrutiny. As Michael D. Pertschuk, former Chairman of the Federal Trade Commission, points out, the likely result would be the euthanasia of Section 7.

> When we are faced with a proposed merger between the third- and fourth-ranking companies in a major industry, ["new learning" economists would] perceive this merger to be a competitive goad to Nos. 1 and 2. If America's giants, Nos. 1 and 2 in an industry, prepare to join hands, [the economists would perceive] that the relevant geographic market is not the United States, but the world. Should the No. 1 and No. 2 breakfast cereal manufacturers in the world become betrothed, [they would] decide that the relevant market is far more commodious than had been thought: egg breeders, croissant bakers, Egg McMuffin vendors, lox and cream cheese purveyors—all [would be] shepherded into one great breakfast market in which the cereal giants will be seen to occupy only modest market shares. Even monopoly need not concern us, they [would] say, unless there exist great "barriers to entry" to potential deconcentrators. But the only barrier to entry that ever seems to disturb our economists is a government grant of monopoly—in which case no merger issue arises. Thus the anticompetitive merger remains a receding mirage, never to be encountered in real life.[28]

This outcome is not entirely speculative. As the Administration's "analysis" and the legislative history of the Merger Modernization Act indicate, the clear intent of the new law is not only to codify the 1984 Merger Guidelines, but also to assure that the "new learning" economics be enshrined as the official standard for interpreting the purpose and the substance of our antitrust laws.

AN ALTERNATIVE PROPOSAL

If enhanced efficiency, technological progressiveness, and greater competitiveness in world markets are to be made a national priority, we would propose a quite different revision of Section 7. We would suggest an outright prohibition of all corporate mergers involving corporations with assets of more than one billion dollars, *unless* the acquiring corporation could affirmatively demonstrate—say, before an expert tribunal like the Federal Trade Commission—that the proposed merger would not be likely to lessen competition in any line of commerce; that it would enhance operating efficiency and contribute substantially to the firm's international competitiveness; and that it would promote technological progress in demonstrably specific ways. Such legislation would, of course, permit any firms, *regardless* of size, to grow by internal expansion—i.e., by building rather than buying. It would even permit growth by acquisition, but only on the basis of proven social advantage rather than on the basis of public relations claims and media hype. Its most positive benefit would be to refocus management's attention on creative entrepreneurship and away from counterproductive financial shell games.

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[28] Pertschuk, *Love That Market*, NEW REPUBLIC, May 14 1984, at 10, 11.

Statement of

THE BELLSOUTH CORPORATION

on

The Impact of the AT&T Consent Decree on Competition in the U.S. and Global Telecommunications Markets

submitted to the

Committee on Finance
United States Senate

February 5, 1987

STATEMENT OF THE BELLSOUTH CORPORATION

This statement is submitted on behalf of the BellSouth Corporation. Its purpose is to demonstrate the importance of the U.S. telecommunications industry to the health of our domestic economy as well as the significant role it plays in U.S. competitiveness abroad. Attached to this brief statement is an appendix which explores the issue of competition in global telecommunications markets in greater detail.

BellSouth Corporation, headquartered in Atlanta, owns Southern Bell, South Central Bell, and BellSouth Enterprises. The telephone operating companies provide local telephone service to 14.5 million customers in Florida, Georgia, North and South Carolina, Mississippi, Louisiana, Alabama, Kentucky and Tennessee. BellSouth Enterprises directs all of BellSouth Corporation's unregulated subsidiaries which provide services in 31 states and several foreign countries. With assets of over $26 billion, revenues of $10.7 billion, and 92,500 employees, BellSouth remains the largest of the regional holding companies formed at divestiture.

In addition to providing distribution services in its local exchange and exchange access markets through its regulated subsidiaries, BellSouth Enterprises provides advertising and publishing, telecommunications terminals, multi-tenant systems, local area networks, international services and products, and cellular mobile telephone systems through its unregulated subsidiaries. BellSouth is committed to maintaining state of the art telecommunications facilities that fully measure up to the demands of its dynamic region, while maintaining consistently high levels of service.

Background

Although telecommunications technology generally has remained stable for many years, technological innovation during the past few years has stimulated customer demand for new equipment and services and created new opportunities for the industry to meet those needs. Unfortunately, our Nation's telecommunications policy has not kept pace with this change. As a result, U.S. markets have been flooded with foreign equipment and large segments of the industry, notably the Bell operating companies (BOCs), are prohibited from competing effectively at home and abroad.

The AT&T Consent Decree prohibits the Bell operating companies, which comprise about half the asset base of the U.S. telecommunications industry, from engaging in manufacturing, providing information services, and providing interexchange service. In its recently-released triennial review of the 1984 Consent Decree, the Department of Justice proposed elimination of the manufacturing and information services restriction, and modification of the restriction against providing interexchange service. The Department bases its recommendations on the fact that the prohibitions no longer are necessary to protect competition, and may be depriving large parts of our society of the benefits of the information age. It also has concluded that BOC participation in these markets will enhance competition and benefit customers.

The benefits referred to by the Department will be apparent both at home and abroad as a result of increased network efficiencies and greater technological innovation. Benefits also will accrue from BOC flexibility to make business decisions, such as -- entering markets, conducting long range research, and planning for future growth. BOC participation in manufacturing, information services and, most importantly, research and development, will contribute to U.S. competitiveness at home and abroad and will help offset the mounting trade deficit by creating new competitive opportunities for American business and the American consumer.

Discussion

The AT&T Consent Decree has significantly contributed to the decline of U.S. competitiveness in global telecommunications markets because the BOCs are prohibited from engaging in equipment manufacturing and providing information services, two lines of business that are leading the information revolution.

The restrictions also contribute to the mounting U.S. trade deficit because: (i) the Decree opened telecommunications equipment markets to competition but, at the same time, prohibited the BOCs from competing at home; and (ii) the manufacturing prohibition discourages the Bell companies from investing in costly, but necessary, research and development programs.

By discouraging BOC investment in research and development, the Decree seriously impairs the long term competitiveness of the U.S. in global telecommunications markets. Unless the U.S. investment in telecommunications R&D increases substantially, and all U.S. firms are encouraged to compete, competition at home and abroad will continue to favor foreign manufacturers.

The Consent Decree's line of business restrictions were designed to prevent the BOCs from using their control over local facilities to impede competition in restricted markets. But as the Justice Department recently concluded, the BOCs do not possess monopoly power either in manufacturing or in information services, and do not control facilities outside their geographic regions.

If the purpose of the AT&T divestiture was to increase competition, then the line of business restrictions should be lifted so the BOCs can apply their considerable expertise and resources to the development of competitive markets at home and abroad. Each of the BOC's regional owners currently has an investment of approximately $22 billion in plant, property and equipment. By contrast, AT&T's comparable investment in plant, property and equipment is $39 billion, or almost double the investment of each BOC.

In 1982 when divestiture was announced, overall U.S. exports were $829 million and imports were $626 million, yielding a positive trade balance of $203 million. By contrast, exports in 1986, two years after divestiture occurred, dropped to $729 million and imports rose to $2261 million, yielding a negative trade balance of $1532 million. The pattern in telephone equipment has tracked the overall picture. Since 1982, the U.S. trade balance in telephone equipment has declined from a surplus of $200 million to an estimated deficit of $1.6 billion.

Research and development is critical to the future of the telecommunications industry, and creating an environment in which R&D is encouraged is important to our Nation's competitiveness. To be a serious competitor in both domestic and foreign markets, a telecommunications, information processing, or other 'high tech' firm must consistently spend between $6000 and $8000 per employee per year on R&D. The BOCs, however, have little incentive to invest in major R&D programs because they cannot recover their costs through participation in manufacturing and information services markets. In 1985, the BOCs collectively spent less than $1500 per employee on R&D, or about 39 percent of the total U.S. industrial average of $3758. By contrast, AT&T's 1985 expenditure per employee was $6545; IBM's was $8525.

As noted above, technological innovation in telecommunications has been advancing rapidly in the last few years which means that existing equipment becomes obsolete at a faster pace. This also suggests that telephone companies must make the most advanced services and equipment available to their customers in order to remain competitive.

Central office digital switches are critical to the future of the industry because local and long distance networks are rapidly being converted from analog to digital technology. By modifying software programs that support existing digital switches, or by adding new switches, telephone companies and other vendors will be able to bring new services to the market that will stimulate competition, increase consumer options, and use the telephone network more efficiently.

Joint efforts by American companies, including the BOCs, in developing these offerings are essential to the enhancement of consumer options and U.S. competitiveness. BellSouth is often approached by American firms seeking R&D funds and venture capital necessary to develop or bring to market enhancements to telecommunications technology, but under the AT&T Consent Decree's restrictions, BellSouth is not permitted to participate.

Conclusion

The line of business restrictions in the AT&T Consent Decree have lessened, rather than increased, competition at home because firms representing over half the assets of the U.S industry are prohibited from participating in the increasingly important, and increasingly foreign dominated, information and manufacturing markets.

Competition would be enhanced, and consumers would benefit from access to a wider array of services and equipment, if the Consent Decree's anticompetitive barriers to market entry were replaced with regulatory safeguards that put all competitors on an equal footing. Most of these safeguards are now in place:

- equal access for AT&T's long distance competitors;
- comparably efficient interconnection (CEI) and open network architecture (ONA) for competitive vendors of enhanced services; and,
- FCC rules governing cost allocation and accounting, mandatory disclosure of technical network design and customer proprietary information, and equipment interconnection practices of regulated carriers.

Replacing anticompetitive barriers with pro-competitive safeguards will benefit U.S. consumers and trade interests alike by encouraging the efficient use of BOC resources and expertise, and promoting more intensive use of the public telephone network. Through greater efficiencies and continued innovation, the U.S. telecommunications industry can chart the future of the global telecommunications market.

BellSouth urges the Finance Committee to consider the relationship between the U.S. telecommunications industry's ability to compete effectively in global markets and the Consent Decree's restrictions that prohibit the BOCs from competing in certain domestic markets. However, in the event the Committee considers legislation addressing this relationship, BellSouth further urges that the U.S. District Court's review of the Justice Department's recommendations be allowed to run its course prior to the Committee taking legislative action. BellSouth would be pleased to furnish additional comments on the subject.

Under the Decree's restrictions, BellSouth and the other regional holding companies must take a back seat to foreign competitors at home because they are prohibited from competing freely in all markets. Foreign companies, which are not similarly restricted, are allowed to operate more freely in the U.S. than the BOCs. American companies should be allowed to compete in America for American business at least as freely as foreign companies. For American legislators and officials trying to deal with our trade imbalance, America would be a good place to start.

By creating a special, restricted category of competitors, the Decree permits foreign companies to enjoy a competitive advantage right here on our own home ground. If the Consent Decree's restrictions were lifted, and the BOCs were treated like other telecommunications companies, they would compete head to head at home and abroad with U.S. and foreign firms. The BOCs should be given the same flexibility as other firms to --

- make business decisions for themselves
- conduct long range planning
- invest in the R&D necessary to develop new products and services

so the U.S. economy and consumers will benefit. Given the freedom to compete, BellSouth and the other BOCs will respond enthusiastically, will enhance our Nation's standing in the global marketplace, will push American technology to new heights, and will yield a rich new array of products and services that will serve the American consumer well in the Information Age.

Appendix

"Impact of the AT&T Consent Decree on U.S. Competitiveness in Global Telecommunications Markets"

BellSouth Corporation

TESTIMONY OF RICHARD T. O'CONNELL
PRESIDENT OF THE CHOCOLATE MANUFACTURERS ASSOCIATION
AND THE NATIONAL CONFECTIONERS ASSOCIATION

TO THE RECORD OF HEARINGS ON THE GOALS OF AMERICAN TRADE POLICY
SENATE COMMITTEE ON FINANCE
FEBRUARY 5, 1987

Chairman Bentsen, Members of the Committee:

The United States confectionery industry, represented by the 118 companies and 65,000 employees of the Chocolate Manufacturers Association and the National Confectioners Association, urges the Committee to include among its trade policy objectives the targeting and elimination of the grossly inequitable foreign tariffs which are the single greatest impediment to the growth of U.S. confectionery exports.

Reciprocity is a term often used to summarize the objectives of U.S. national trade policy. American exports should have the same opportunity in foreign markets as imported goods have here. Rarely is the absence of reciprocity more marked than in international confectionery trade. The U.S. is an open market. Tariffs of 5% and 7% are among the lowest in the world and nontariff barriers are absent. In return for free access to the U.S. confectionery market, Japan maintains highly protectionist tariffs of 20% on chocolate and 35% on sugar confectionery. Canadian duties average 13%; Europe, 15%. Taiwanese tariffs are 25% on chocolate and 67.5% on sugar confectionery. The Korean duty on chocolate is 30% and 25% on sugar confectionery. Most of these nations enjoy substantial trade surpluses with the U.S. and yet maintain unreasonably high tariff barriers to American confectionery exports.

The current depreciation in the value of the dollar that will help the overall competitiveness of U.S. exports is not the answer when overseas sales are suppressed by tariff and nontariff barriers. The U.S. trade deficit reached an all time high of $170 billion last year despite a 60% decline of the dollar against the yen and 30% to 40% against European currencies. One third of the new debt is with one country - Japan. I suggest to the Committee that the decline in the dollar/yen value over the past 18 months has had so little impact because trade with Japan is essentially a one-way street.

Except for raw material imports necessary to run Japan's manufacturing sector, Japanese imports are carefully controlled through tariffs and other restrictive trade barriers. These barriers limit U.S. exports. Consequently, Japanese manufacturing firms are able to export their goods into an open U.S. economy which is consumer oriented, but efficient U.S. manufacturers are unable to compete with their Japanese counterparts because of Japan's protective measures.

A case in point is the chocolate manufacturing industry. The U.S. chocolate and sugar confectionery industry is one of the most efficient in the world. It is capital intensive with highly sophisticated manufacturing facilities.

The industry's consumption of sugar and milk is vital to this nation's agricultural sector. Another important raw material, cocoa, is sourced from developing nations of Africa and South America and in the near future the State of Hawaii will produce the first domestic cocoa crop.

In spite of technological and natural resource advantages, U.S. chocolate and sugar confectionery exports to Japan still constitute only one percent of the Japanese market after a decade of determined effort. Further, the 20% duty (C.I.F. value) on imported chocolate confectionery combined with highly restrictive rules regarding promotion and discounting of products at the wholesale and retail levels has limited U.S. exports to an average $15 million in a $2 billion market.

What are the problems that keep an efficient U.S. confectionery industry's exports to Japan at a minimum? And, what can Congress do to secure trade reciprocity from Japan and better position American exporters to take advantage of the substantial growth in the Japanese confectionery market that is expected in the decade ahead?

First I would ask that the Committee not abandon the priority of eliminating overseas barriers, especially tariffs, in hopes a realignment of the dollar will offset the damage of these barriers.

Japan's 20% C.I.F. tariff on chocolate added on to ocean freight and insurance costs, which total 7 to 10%, means that U.S. chocolate manufacturers must be 30% more efficient to compete with the big five Japanese chocolate companies. Even then, new market entrants or manufacturers introducing new chocolate products are not allowed to offer coupon discounts of more than 3%, i.e. 1.2 cents off on a 40 cent bar; cannot give a premium offer with purchase worth more than 2%; cannot pass out leaflets at the store front; cannot advise potential customers to "ask your store" if they have the product; and cannot offer samples larger than an amount which allows the consumer to know the flavor.

Given the tariff and the trade restrictions, the yen/dollar value would have to fall to 110-120 from the current 152 in order for U.S. chocolate manufacturers to compete on a level playing field with the Japanese. It is doubtful this revaluation will be allowed because of the economic difficulties it would cause in Japan during the next few years.

Consequently, the only hope that American confectionery manufacturers have of penetrating a growing, dynamic market is for Congress and the Administration to maintain pressure on the Japanese to reduce confectionery tariffs to the same level as the United States' rates of 5% and 7%.

To assure that achieving trade reciprocity will not depend entirely on unilateral concessions by our trading partners, we urge a renewal of the President's tariff negotiating authority under the Trade Act of 1974 as well as authority for the new round of multilateral trade negotiations.

Negotiating authority could be a useful tool in freeing some of the bilateral tariff issues such as Japan's tariff on chocolate that have become intractable despite continuous pressure from Congress and the Administration. Progress on this and other matters would contribute a positive momentum for the new round and help alleviate concerns in the business community that improvements in market access will be suspended for the duration of GATT multilateral trade negotiations.

The U.S. confectionery industry has already waged a long campaign to open lucrative foreign markets. Our progress can be measured not just in declining foreign tariffs such as 75% to 25% in Taiwan and 55% to 30% in Korea but to an average 40% increase in export sales. We ask that Congress provide the President and lead trade policy agencies with the authority to secure for American confectionery manufacturers the same opportunity for their products overseas as imported confectionery receives in the United States.

Statement of
Ford Motor Company
Senate Finance Committee Hearings on Trade
January 28, 1987

Ford Motor Company is extremely pleased that the Senate Finance Committee is moving so promptly to review the U.S. trade situation and work toward trade legislation.

From the viewpoint of an industry that was one of the first to experience the impacts of trade imbalances, it seems as though we have been talking about the trade issue or its close associates, industrial policy and industrial competitiveness, forever. And while we have been debating it in the U.S., our trading partners have capitalized on an overvalued U.S. dollar and an expanding U.S. economy to grab a major foothold in the U.S. market.

However, the sharply rising U.S. trade deficit finally seems to have succeeded in getting everyone to recognize that the U.S. has a major problem and to start seeking realistic solutions. That's welcome news.

Let's look first at the problem. By any measure, U.S. trade accounts have reached crisis proportions. The 1986 trade deficit is projected to reach nearly $175 billion. The current account is a broader trade competitiveness measure, including not only merchandise trade, but also trade in services and income from investments abroad. This account has been in the red since 1981 and will reach $140 billion in 1986 (Exhibit I).

Estimates of the impact of these deficits on U.S. jobs vary only in degree. A study by a Department of Commerce economist estimates that the trade-related job loss in the U.S. manufacturing sector was over 2.0 million; other estimates range as high as 3.0 million.

Since 1980, average U.S. GNP growth has run well below the estimated potential growth rate because of the drag of the U.S. trade deficit (Exhibit II).

The major impacts of worsening trade deficits have been felt in those industries that are particularly sensitive to foreign trade. But the impacts go well beyond the auto, steel, and other basic industries, which should have been regarded as a warning flag. The President's Commission on Industrial Competitiveness found that even in high-technology industries, the U.S. has lost world market share in 7 out of 10 sectors. Industries including computers, semiconductors, telecommunications, and analytic instruments are now suffering from the effects of massive trade imbalances.

Another impact of the rising trade and current account deficits is the build-up of net U.S. debt to foreigners. The rising U.S. trade and current account deficits and budget deficits have been financed by increasing U.S. foreign debt. By the end of 1986, the U.S. foreign indebtedness reached an estimated $250 billion.

The U.S. has attracted so much foreign capital to finance the trade deficit that it changed from a creditor to the world's largest debtor in just three years, after being a net international creditor since 1914. This inflow of foreign capital has allowed the U.S. to live beyond its means, but most experts believe continued rapidly increasing debt is unsustainable and could lead to a very difficult correction. Further, servicing the accumulation of international debt is costly and will depress future growth and affect the U.S. standard of living. The U.S. foreign debt has been estimated to increase to $500-$800 billion by 1990. This range implies a servicing cost of $40-60 billion annually (Exhibit III).

There has also been a fundamental erosion in U.S. manufacturing. The persistent rise in the value of the dollar between 1980 and 1985, coupled with the relative openness of the U.S. market led foreign firms to increase production for the American market. Imported good's share of the U.S. market increased by over ten percentage points to nearly one-third of all goods sold in the U.S. in 1986 (Exhibit IV).

Capitalizing on an expanding U.S. market and relatively higher U.S. producer costs due to the strong dollar, foreign producers from traditional trading partners captured increased market share and new competitors entered the market. This will have lasting competitive effects -- making it more difficult for U.S. producers to recover domestic market share even as the dollar becomes more competitive. Once again, this extends far beyond U.S. basic industries. The import share for computers rose from 7% in 1981 to 18% in 1985. According to data assembled by the National Association of Manufacturers, the trade account in high technology goods changed from a $26.6 billion surplus in 1981 to a deficit of $2 billion in 1986 -- and these inroads will not be readily abandoned by foreign producers.

Americans understand that there is a tradeoff between jobs and imports. In a recent Roper public opinion survey, 76% believe that jobs are more important than lower prices for American consumers (Exhibit V).

How did we reach this trade crisis? There are a number of factors worth mentioning. The U.S. federal budget deficit kept upward pressure on real interest rates and attracted capital from other countries. The result was a stronger dollar and more expensive U.S.-produced goods and services.

Declining U.S. competitiveness, due to relatively lower U.S. productivity growth, rising costs of production and shortfalls in product quality played a part, but not the large part that seems to have become fashionable to cite. As noted in Exhibit I, as recently as 1981, the U.S. had a current account surplus.

The short time it took for the U.S. to shift from surplus to deficit should call into question those who wish to blame management or U.S. workers for the trade problem. As Dr. Martin Feldstein, former Chairman of the President's Council of Economic Advisors and President of the National Bureau of Economic Research, wrote recently:

> "...fundamental aspects of American industry cannot change in as short a time as the five years in which the United States has gone from trade surplus to trade deficit. For the same reason it is wrong to attribute the massive trade deficit to a fundamental deterioration of U.S. productivity, of American product quality, or of other basic aspects of potential competitiveness. The primary reason for our deteriorating trade imbalance was the 70% rise of the dollar that occurred between 1980 and the spring of 1985." (Exhibit VI)

Further, the issue of competitiveness is more properly one of the competitiveness of the U.S. as a production base, not of American companies in a worldwide context, including foreign subsidiaries. As Exhibit VII notes, U.S. multinational companies have managed to retain their share of world trade, despite the strong dollar. Profitable production can be maintained by production outside the U.S. What's at stake is U.S. jobs, the U.S. technological base, and U.S. industrial capacity.

Another factor is the $1 trillion debt of the less developed nations. To service their foreign debts, the developing countries have simultaneously boosted exports and cut back purchases of U.S. goods to minimize capital outflow.

Unfair trade practices by other countries -- barriers to U.S. goods and export incentives -- contributed to the trade deficit, although many of these were in place prior to 1980. Dr. Feldstein also cites the decline in real price of oil and relatively slow growth overseas as contributing causes, but states unequivocally that "none are as important quantitatively in raising the U.S. trade deficit as the sharp appreciation of the dollar."

No matter what order of causation one chooses, there seems to be increasing agreement that the present levels of current account deficit and foreign debt are unsustainable and could lead to a very difficult correction.

Economists believe -- and history suggests -- that the current account will eventually go back toward balance because the willingness of foreign investors to accumulate dollar assets is not unlimited. The U.S. trade deficits, therefore, cannot be financed by an ever increasing inflow of foreign capital. But without a sound and coordinated U.S. policy, there can be serious impacts on jobs and industries in the meantime as well as a possible hard landing for the dollar.

As MIT economist Lester Thurow notes:

> "Theoretically one should not worry about the demise of American companies and industries ... but reality is marked by very large transition costs and lots of irreversibilities. Given severance pay, early retirements and low prices for used machinery, the costs of going out of business can be enormous. Given the need to acquire and train a labor force and to develop distribution and marketing networks, the costs of getting back into business are even larger. Once a market position is lost and customers have developed relationships with foreign suppliers, it can be virtually impossible to get back into business. As a result, countries have to worry about the long-run industrial costs of intermediate-run overvaluation of their currency."

Given the very real jobs and dislocation impacts already felt by U.S. industry, U.S. policy should strive to accelerate the return to equilibrium in our trade and current accounts in order to arrest the negative impact on U.S. jobs, industrial capacity, and technology development that is occurring.

First and most important, the U.S. should set a goal and a timetable for restoring balance in the current account. As Exhibit VIII shows, a five-year timetable would bring the current account back into balance on approximately the same curve that it has deteriorated since 1981.

The major action necessary to achieve the goal of current account balance must be a continuation of actions to restore the dollar's competitiveness. The yen appreciation has not yet resulted in progress on reducing the $60 billion trade deficit with the U.S. Currency adjustments can be painful, as U.S. industry learned with the rapid escalation of the dollar in 1980-85, but the longer the imbalances, the greater the potential consequences for the U.S. and its trading partners alike.

More than half of total U.S. trade is accounted for by countries with currencies that have not appreciated against the U.S. dollar since January, 1985. This has given these countries -- particularly Korea, Taiwan, and Hong Kong -- an unwarranted cost advantage that has translated directly into an increase in imports from those countries. Imports from Taiwan, South Korea, and Hong Kong now account for 12.5% of total U.S. imports. The U.S. should continue its efforts to make the U.S. dollar competitive with the yen and European currencies, but should also step up negotiations with the Far East NIC countries toward prompt, substantial appreciation of these currencies (Exhibit IX).

Some have raised the question of whether balancing the U.S. current account could throw the U.S. into recession. That clearly needs not be the case. A weaker dollar will raise the cost of imported goods, however, it will also make U.S. goods and services more competitive, which will stimulate U.S. production. The net impact on GNP should be negligible -- certainly not enough to cause a recession.

Second, while we pursue the overall goal of restoring balance in our current account, we cannot ignore bilateral trade deficits that are large and chronic. After eight series of market-opening initiatives, the U.S.-Japan trade deficit continues to rise. It is clear that we need to send Japan a very strong signal that its trade surplus with the U.S. -- which reached nearly $60 billion last year -- is unacceptable and must be reduced.

Japan missed a major opportunity to take positive action to reduce the automotive trade deficit, which accounts for half of the total bilateral deficit, when it announced plans to keep shipping 2.3 million 100% made-in-Japan cars to the U.S. In addition to the cars shipped to the U.S., Japan is assembling more and more cars in the U.S., which contain mostly Japanese-made parts. Ford had recommended that Japan cut its car shipments to the U.S. to below 2.0 million units just to keep the automotive deficit where it is. The announcement signals a lack of intent on Japan's part to seriously address this imbalance.

Steel, semiconductors, machine tools and a host of other industries present similar sectoral challenges. And in other sectors, the problem is reciprocity -- easy access for foreign manufacturers to the U.S. market, but a web of obstacles for U.S. products in foreign markets. Market opening actions, export promotion and export financing programs should continue to be pursued zealously.

In bilateral negotiations, the U.S. goal should be a reduction in the trade accounts that are most out of balance and action on sectoral problems where there are likely to be severe losses in jobs and manufacturing capability before balance can be restored.

Third, the U.S. must take aggressive action to reduce the federal budget deficit and adopt policies to encourage savings and investment. A continued decline in government borrowing to offset the reduced capital inflow from abroad would help hold down interest rates and maintain investment activity. Good progress has been made in reducing budget deficits, but the Administration and the Congress must work together to avoid any backsliding during this critical period (Exhibit XI).

Fourth, U.S. policy must encourage U.S. firms to step up action to improve competitiveness and they must do so. Those industries and firms that survived the rapid rise in the dollar that led to increased import competition at home and abroad have made major strides in improving competitiveness.

At Ford, product quality has improved dramatically in recent years. Based on customer research, the quality of 1986 models is more than 50% better than that of 1980 models -- better than its domestic competition, exceeding some imports, and closing the gap rapidly. Investments for the aerodynamically-styled Ford Tempo, Thunderbird, Taurus, and Aerostar and Mercury Topaz, Cougar, and Sable -- which now have established Ford as a leader in the "look of the future" -- were committed in the years when things looked darkest.

Ford has reduced its operating costs by about $5 billion since 1979 and its breakeven point by over 30%. Salaried employment has been reduced by about 30% and plans are under way to trim an additional 20% or more in our automotive business during the next five years. Moreover, since 1980, Ford worldwide productivity measured on a vehicles per employee basis is up 45% and over the same time period, the number of labor hours per vehicle produced fell some 30%.

These are the kinds of actions that American industry must take to survive against foreign producers with dramatically lower costs -- and there is much more to be done.

Fifth, U.S. policy should provide a better "safety net" for workers who are displaced by a combination of import competition and the productivity and competitiveness actions that are required in response. We generally support the recommendations of the Secretary of Labor's Task Force on Economic Adjustment and Worker Dislocation, including proposed increases in funding for trade adjustment assistance and the Jobs Partnership Training Act.

Sixth, the U.S. also must examine all federal policies with a view toward industrial competitiveness. Laws and regulations that disadvantage U.S. producers should be revised and the economic impact of the tax reform bill should be carefully monitored to evaluate whether the economic stimulation we hope will occur compensates for the substantial increase in the tax burden of U.S. industry.

Seventh, U.S. policy should be to continue to encourage our trading partners to stimulate domestic economic growth. Dr. Feldstein notes that if all countries outside the U.S. were to increase real rates of economic growth from a projected average of three percent per year for the next two years to five percent, this by itself would only raise the demand for U.S. exports by about $15 billion -- less than one tenth of the total trade deficit. But domestic growth in trade surplus countries can serve to offset the pain of correcting their trade imbalances with the U.S.

Eighth, the U.S. should also develop a strategy for a successful resolution of LDC debt. LDC policy should focus not just on debt service, but the steps required to resume and maintain economic growth. It is also important to increase the role of capital surplus countries -- particularly Japan and Germany -- in solving the LDC debt problem.

Ninth, while the quantitative importance of unfair trade practice is not great, the U.S. needs to take stronger steps against unfair trade practices to relieve the impacts on businesses hardest hit by such practices. Therefore, we support changes to current U.S. trade law that would:

- Transfer authority to take action under Section 301 from the President to the U.S. Trade Representative and establish guidelines for implementation of final decisions in 301 cases in a timely manner;
- Make qualification for relief under Section 201 consistent with GATT article XIX as part of harmonizing world trade laws; and
- Enhance the protection of intellectual property.

Tenth, in the interest of promoting and fostering worldwide trade, Ford supports presidential authority to enter into multilateral trade negotiations, provided that the Administration establishes specific negotiating objectives that properly reflect the nation's trade interests and that there is regular consultation with Congress, business, labor and consumers throughout the negotiations.

There are many interrelated policy areas that must be addressed if we are to turn around the trade imbalances that have so affected U.S. industry and it will be difficult to devise trade legislation that is tough but fair.

Ford believes the fundamental goals of U.S. trade legislation should be:

- to set a goal of achieving current account balance. A five-year period would reasonably parallel the period of decline;
- to establish a currency regimen that will lead to a competitive dollar and achievement and maintenance of current account balance; and
- to facilitate the ability of our negotiators to redress trade imbalances on a multilateral, bilateral, and sectoral basis as required.

Thank you for the opportunity to express Ford's views on this issue of vital national importance. We hope that the committee can be instrumental in structuring legislation that will restore U.S. trade competitiveness.

Ford Motor Company

January 28, 1987

Exhibit I

The U.S. Trade Crisis

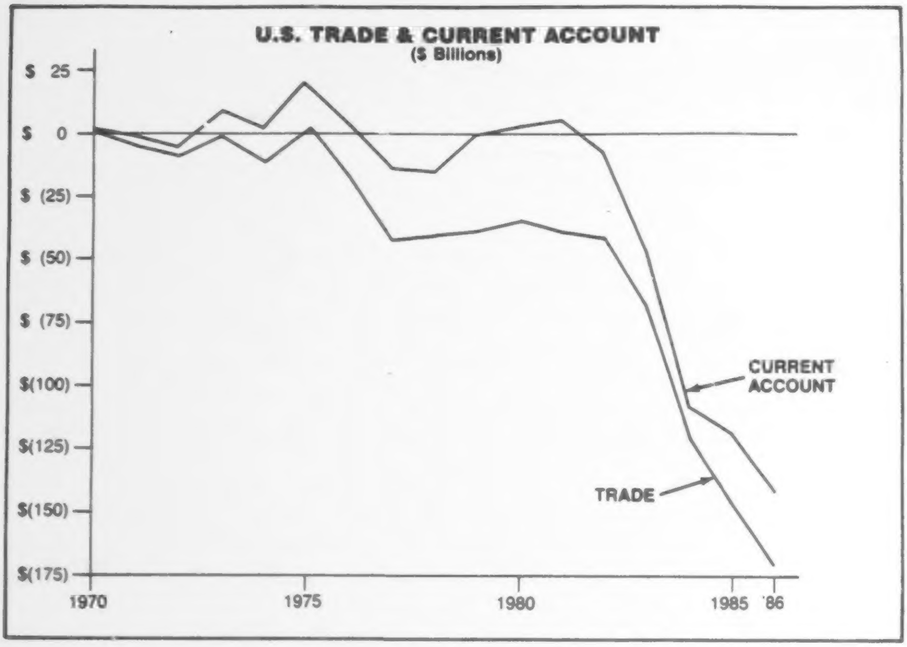


Exhibit II

The Trade Deficit Has Hurt Employment and Been a Drag on GNP

Experts disagree about the level, but most agree that there have been major employment impacts from the trade deficits:

Source	Estimated Manufacturing Job Losses
C. Fred Bergsten, Director, Institute for International Economics (Spring 1985)	3 million
David Lund, Dept. of Commerce (January 1986)	1.5 million loss to imports 1.1 million loss from few exports
Office of Business Analysis, Dept. of Commerce (January 1985)	2.3 million lost to net trade
U.S. Commissioner of Labor Statistics (June 1985)	2.0 million
Roger Brinner, Chief Economist, Data Resources, Inc. (1985)	just under 2 million

In addition to the loss in manufacturing jobs, the trade deficits have reduced total GNP for the last six years.

U.S. GNP Growth

	1980	1981	1982	1983	1984	1985	Est. 1986
. GNP Effect of Net Exports	1.6%	(0.3)%	(0.6)%	(1.5)%	(1.9)%	(0.7)%	(1.1)%
. Domestic GNP	(1.8)	2.2	(1.9)	5.1	8.3	3.4	3.8
Total GNP Real Growth	(0.2)%	1.9%	(2.5)%	3.6%	6.4%	2.7%	2.7%

Exhibit III

Foreign Debt Has Also Reached Crisis Proportions

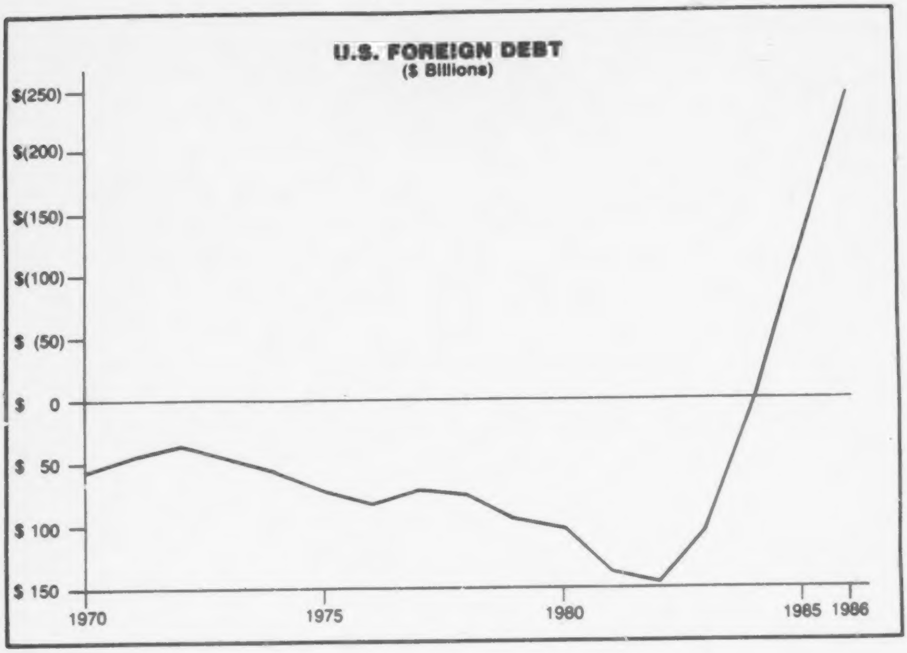


Exhibit 17

Imports Have Sharply Increased Their Share of the U.S. Market

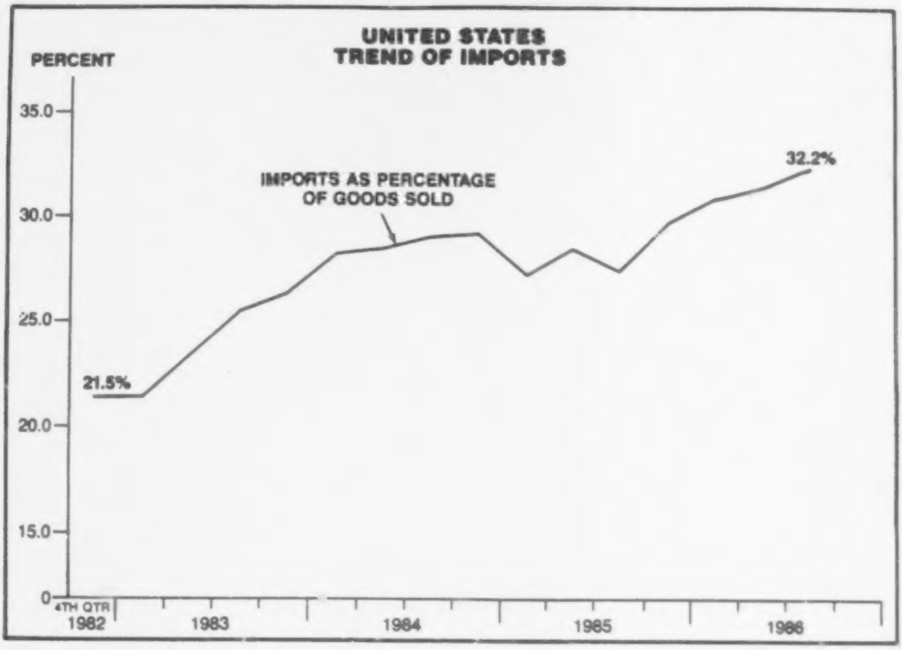


Exhibit V

Americans Understand There is a Trade-off Between Imports and Jobs

In a Roper public opinion survey conducted last October-November, respondents were asked: "What do you think is more important -- more jobs for the American workers or lower prices for American consumers?"

Ans.

More jobs for workers.......76%

Lower prices for consumers..17%

Don't know...................6%

EXHIBIT VI

The Deterioration in the Trade Accounts is Due Mostly to the Sharp Appreciation of the Dollar

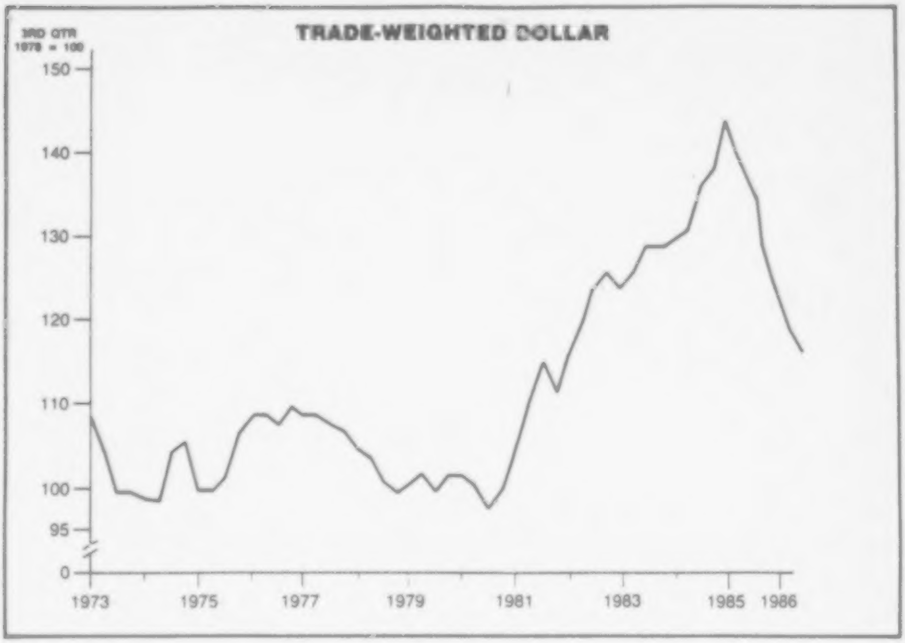


Exhibit VII

Multinational Companies Find Ways to Remain Competitive Despite Currency Distortions

	Share of World Exports of Manufacturered Goods Held by:		
Year	All U.S. Exporters		U.S. Multinational Corporations, in the U.S. and Overseas
1957	22.7%		n.a.
1966	17.5		17.7%
1977	13.3	down 39%	17.6
1982	14.3		17.7
1983	13.9		17.7

Source: National Bureau of Economic Research

Exhibit VIII

The U.S. Goal Should be to Restore Current Account Balance

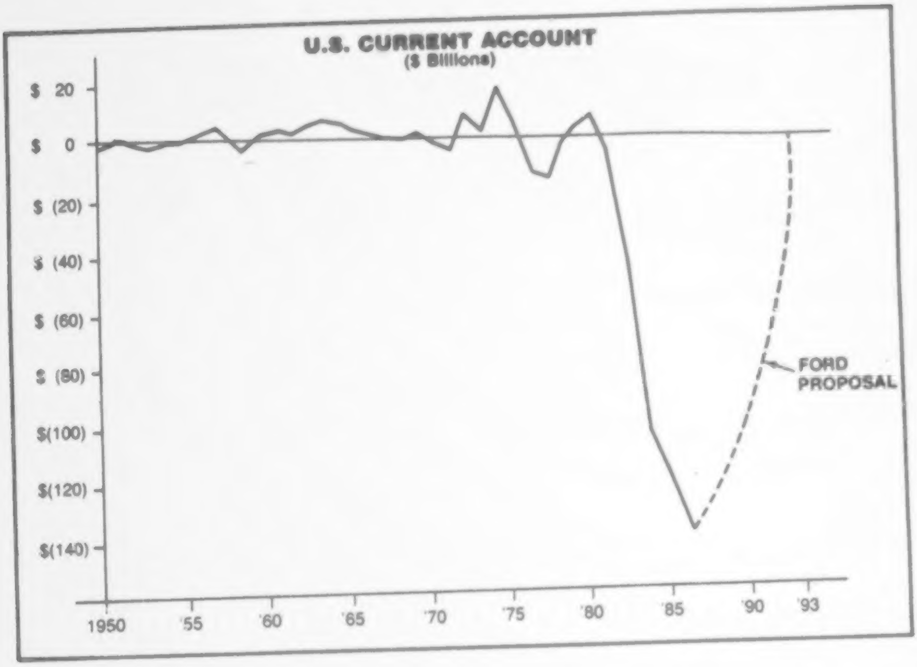
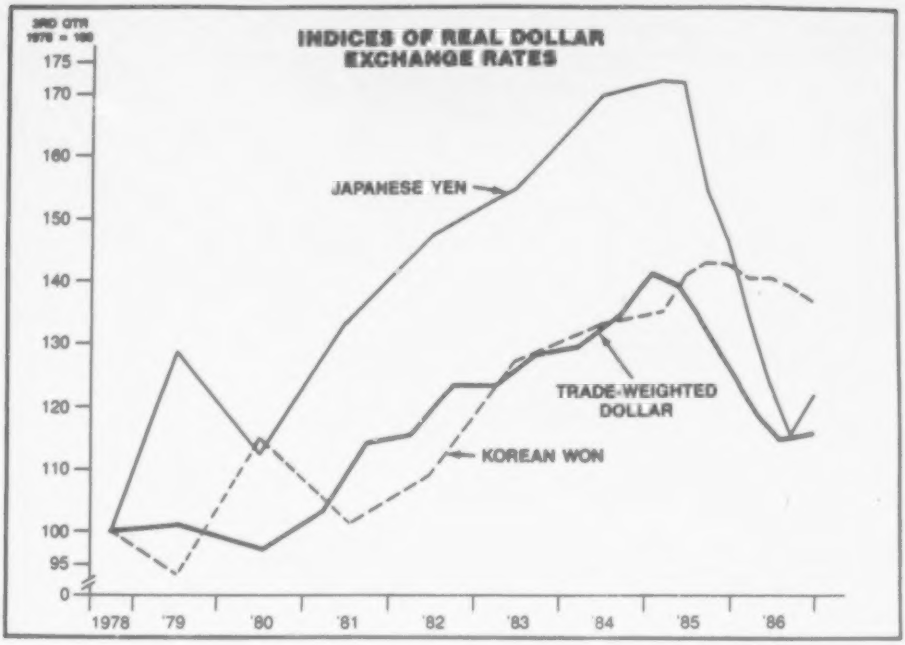


Exhibit IX

Action on Currency is Key to the Trade Problem



Some Bilateral Trade Problems Demand Attention

Exhibit X

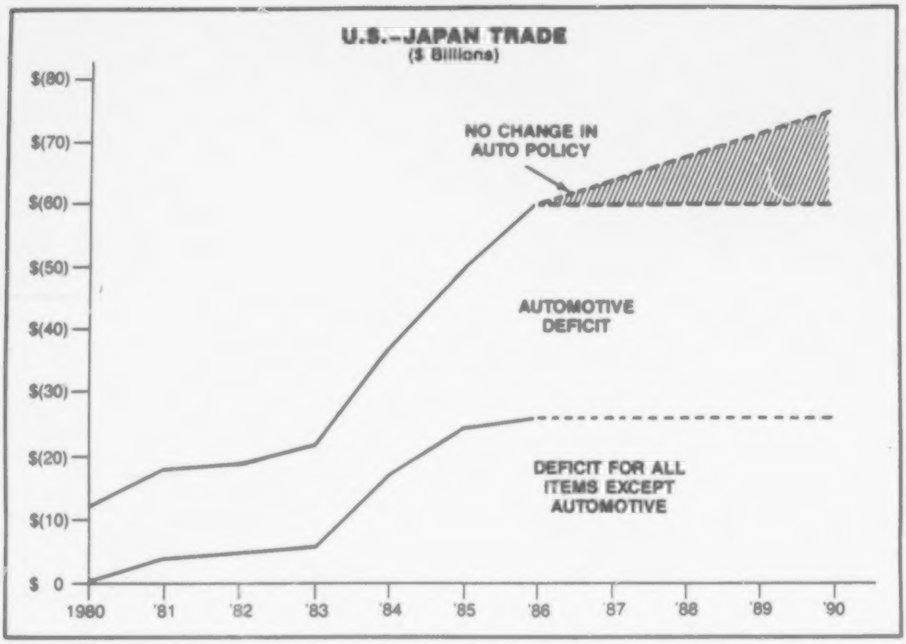


Exhibit XI

The U.S. Budget Deficit is an Integral Part of the Problem

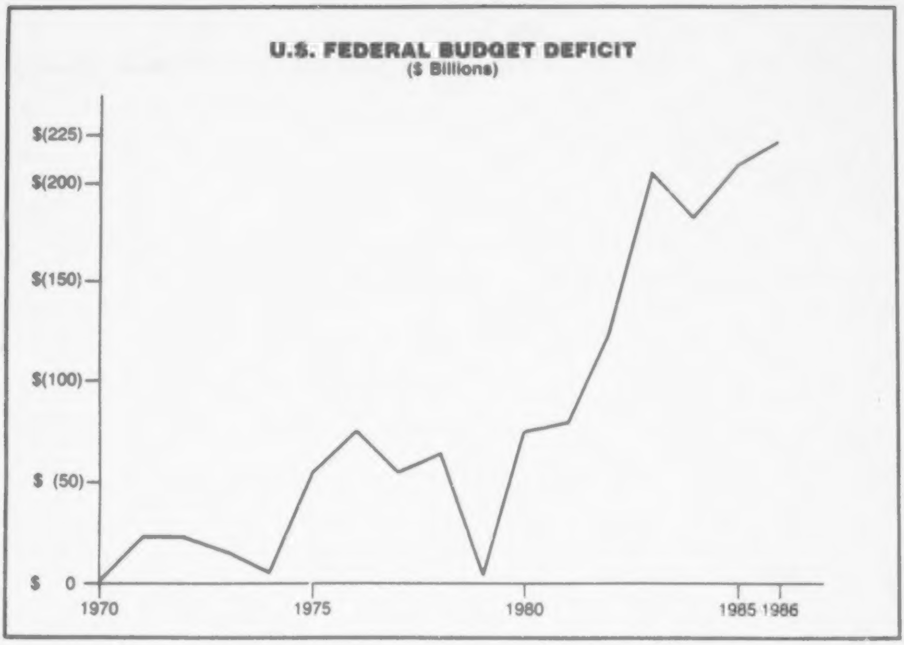


Exhibit XII

Goals for U.S. Trade Policy

- Set goal of achieving a balance in the current account in five years.
- Establish a currency regimen that will lead to a competitive dollar and achievement and maintenance of current account balance. Major action is needed on currencies, such as the Korean won and the Taiwanese dollar, which have not strengthened with the yen.
- Continue to press for reductions in bilateral trade accounts that are most out of balance and continue to attack sectoral problems where there are likely to be severe losses in jobs and manufacturing capability before balance can be restored.
- Take aggressive action to reduce the federal budget deficit.
- Encourage U.S. firms to step up actions to improve competitiveness.
- Provide a better "safety net" for displaced workers.
- Eliminate or modify laws and regulations that disadvantage U.S. producers.
- Continue to encourage our trading partners to stimulate domestic economic growth.
- Develop a strategy for a successful resolution of LDC debt.
- Take stronger steps against unfair trade practices to relieve the impacts on businesses hardest hit by such practices and to protect U.S. intellectual property.
- Enter into multilateral trade negotiations, but with negotiating objectives reflecting the nation's trade interests and regular consultation with Congress, business, labor and consumers.

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Hon. Lloyd Bentsen
United States Senate
Committee on Finance
SD-205 Dirksen Senate Office Building
Washington, D.C. 20510

attn: William J. Wilkins
Staff Director and Chief Counsel

Mr. Chairman and Members of the Committee. I am Dr. Peter Nelsen, an economist, President of the International Trade Council (ITC), and Chairman of the International Development Institute (IDI). IDI is a research and educational organization dedicated to the development of international trade and the transfer of appropriate technology to meet basic human needs.

I would like to commend the Chairman for conducting this series of hearings early in the 100th Congress to explore the whole scope of international economics and the role the United States will play in the international marketplace. The administration, the Congress, and certainly the private sector all recognize a need for us to reduce our growing trade deficit. The increased political attention to trade as an issue in addition to the introduction of several significant trade bills already in this Congress indicate the depth of concern within the Congress.

Global economics should translate into global political security. The economic development of the Third World continues to be our best investment against the encroachment of hostile political systems or the development of ineffective economic systems. At the present time 40% of U.S. exports are to going to developing countries - more than to Western Europe and Japan combined. Exports account for one out of six manufacturing jobs in the United States and the produce of two acres out of five from American farms.

U.S. government data shows U.S. export growth to be neglible for the 15 years since the early 1970's despite attractive, vast exporting potential. Furthermore, only 275 U.S. companies (out of tens of thousands having exporting capabilities) command 80% of the $240 billion foreign trade market. Just as every businessman in America needs to be concerned about the size of his marketplace, we think most businessmen in America should be able to expand the locations of his market. We should not begin now to establish dangerous barriers to market expansion when we in the United States posess the greatest potential for market growth.

A 1982 survey conducted by the U.S. Senate Committee on Small Business indicated that four major obstacles accounted for 70% of the reasons why potential exporters decline to participate in the world market. The four reasons, lack of information, regulations, expenses, and financing along with lesser contributing problems are addressed in the International Development Institute's trade and development system, sponsored by the International Trade Council.

The economic strength of the private sector is one of our greatest national assets insuring not only economic and national security, but also providing us with a favorable exporting opportunities to improve the quality of life here and overseas. The Congress can help strengthen our role in the world markets by keeping trade barriers down and by encouraging greater participation in the international market by small and medium-sized businesses.

Thank you, Mr. Chairman, and members of the Senate Committee on Finance for permitting me to submit this written testimony on "Mastering the Worldeconomy".

Sincerely,

Dr. Peter Nelson

Dr. Peter Nelson, President
International Development Institute
by Steven Lindroth, Director SL
Government Relations

PN/sl

National Association of Wheat Growers
415 Second Street, N.E., Suite 300, Washington, D.C. 20002, (202) 547-7800

February 5, 1987

The Honorable Lloyd Bentsen
United States Senate
Washington, DC. 20510

Dear Mr. Chairman:

The National Association of Wheat Growers commends the Finance Committee for its series of hearings on trade policy revisions. Our association devoted considerable attention to trade and export policy during our annual convention, which concluded last week. I would like to share with you some of NAWG's perspectives on the issues your committee will soon address, and respectfully request that this letter be made part of your hearing record.

NAWG believes the following principles should guide U.S, trade policy:

- The United States should move swiftly and aggressively, under existing authority, against unfair trade practices that harm American businesses and workers.
- The federal government should move quickly and comprehensively to address important factors contributing to the U.S. trade deficit, including the federal budget deficit and relative dollar exchange rates.
- U.S. trade policy should be developed in a comprehensive manner, recognizing that exports create jobs. It should be U.S. trade policy to avoid actions that benefit one sector to the detriment of others and to the detriment of the national interest.
- Any new trade legislation should be consistent with U.S. international obligations and should have the effect of strengthening the president's ability to expand U.S. exports, rather than creating new U.S. import restrictions.

"WHEAT DOLLARS ARE IMPORTANT TO THE NATIONAL ECONOMY AND YOUR BUSINESS"

- U.S. international policy must recognize the critical need to enhance our exports and to minimize export disincentives.

- U.S. trade policy should not undermine the economies of our trading partners in developing countries. Such actions only shrink long-term U.S. export markets and threaten the international financial system.

- The United States should actively promote comprehensive multilateral negotiations to expand trade in goods and services, and should work toward strengthening the international economic system. Fair and open trade demands reciprocal trading opportunities.

Wheat growers are firmly committed to exports: over half of all wheat produced in the U.S. will be exported this year. At the same time, wheat growers have seen exports shrink in recent years: In 1981/82 nearly two-thirds of America's wheat crop was shipped overseas. This decline, as you know, is not unique. Most other agricultural commodities have seen export volume, market share and consequently prices decline during the 1980's.

There are several positive steps that can be taken by Congress and the Administration to increase wheat exports:

- Existing export programs should be used more effectively. A recent study by a number of agricultural groups including U.S. Wheat Associates found 17 million metric tons of potential increased demand -- including 4 million tons of wheat -- that could be realized through better and more careful use of USDA's current authorities, without changing a single law.

- Congress should provide adequate resources for those agencies of USDA that directly enhance U.S. competitiveness. For example, the Foreign Agricultural Service has a role in administering several programs created or greatly expanded by the Food Security Act of 1985 -- The Export Enhancement Program, GSM-103 Intermediate Credit Guarantees, PL480, Targeted Export Assistance and Section 416 donations -- but has fewer staff to carry out its responsibilities than it did 10 years ago. We believe additional personnel and resources are clearly justified for FAS.

- The macroeconomic sources of oversupply and anemic demand must be addressed. Notably, the third world debt crisis has hurt U.S. agriculture because developing countries are able to import less from the U.S., and are encouraged to produce export crops whether or not they have a comparative advantage to do so, in order to gain foreign exchange.

- It is vital to maintain pressure on exporters -- like the European Community -- who subsidize exports while making no real attempt to curb overproduction. The Export Enhancement Program should be offered to all our customers to counteract the predatory pricing of our competitors.

- The U.S. should begin the Uruguay Round of trade talks without illusions about the ease of reforming world agricultural trade, but at the same time realizing that this may be our last best hope of preventing utter chaos in the world trading economy. NAWG believes the U.S. should aim at an agreement by which short-term reductions in grain supply are shared equitably among producing countries, as opposed to the current situation where the U.S. alone attempts to restrain overproduction. In addition, a workable agreement should phase out the use of export subsidies.

Mr. Chairman, we will be making more specific suggestions in the coming weeks and months. We appreciate the chance to comment, and look forward to working with you. We reiterate that the best trade bill is one that boosts exports, rather than restricting imports. Open trade is, in the end, the best means of assuring fair trade. The United States in its trade posture should be neither a patsy nor a bully; we should stand firm for our rights, and be willing to give both customers and competitors a fair deal in return.

Sincerely yours,

Jim Miller

Jim Miller
President

NDPC National Democratic Policy Committee

Lyndon H. LaRouche, Jr.
Chairman Emeritus
Advisory Council
Warren Hamerman
Chairman
Barbara Boyd
Treasurer

Testimony

Submitted to the

SENATE FINANCE COMMITTEE

HEARINGS ON

TRADE

Submitted by the
National Democratic Policy Committee
Ronald Kokinda
1612 K St., NW
Washington DC

January 22, 1987

Thank you Mr. Chairman for the opportunity to present a statement on trade policy.

A remedy for our current disasterous trade deficits will require certain bold policy changes, changes which may not be achievable by normal means of "consensus" politics, but could be achievable under true leadership.

The statement which I submit to you today is in three parts: a statement and analysis of the current trade situation; a statement by Mr. Lyndon H. LaRouche, on the relationship between the threat of decoupling of our nation from our European allies and the trade crisis; and proposed legislation which defines the scope of measures which will be required to generate a real economic recovery.

I would like to quote from Mr. LaRouche's recent paper, "The 'New American Century' Doctrine: LaRouche's Challenge To Moscow," to properly situate the response we must make to the trade crisis:

"Under emergency conditions, the President of the United States has the combination of legal powers and ready support from the Congress, sufficient to stop a collapse and reverse an economic depression very rapidly. This action is based on the fact that the physical capacity to produce wealth is real, whereas money is merely paper. If the government acts to freeze non-performing accounts of banking institutions, suspend foreclosures, and kindred measures, it is then feasible to steer large masses of new credit into investments in building infrastructure, reviving agriculture and manufacturing employment, and generating large volumes of exports of manufactured and agricultural goods. These measures are drastic by ordinary standards, but nothing short of such measures will do even the slightest good under such conditions. The thirty to fifty percent increase in average physical output of the U.S. economy, which could be accomplished over a four year term, would permit adequate defense and would enable us to turn over the temporarily frozen non-performing financial assets."

ANALYSIS OF THE TRADE CRISIS

The magnitude of the disaster implicit in the Administration's decision to institute trade-war measures, including competitive devaluation of the U.S. dollar, against our trading partners, may be properly guaged by comparison of the present economic crisis to conditions prevailing during the 1970's, as well as during the 1930's.

_If_ the United States did not have to import net a fifth of its consumption, and _if_ it did not have to borrow $150 billion a year from foreigners to do so, and _if_ this $150 billion did not also finance the federal deficit, then Washington's decision Jan. 14 to hasten the crash of the dollar on overseas markets, might be excused as a mere act of colossal stupidity, on the scale of the worst Anglo-American blunders of the early 1930s.

As matters stand, it is much worse.

It might be said in defense of the disastrous 1929 Hawley-Smoot tariff, that its framers were fighting for a greater share of a world trade volume then still at relatively high levels. Secretary of State George Shultz, Trade Representative Clayton Yeutter, and their correspondent trade-warriors on the European side, have no such excuse. Their policies have already collapsed world trade, and their emulation of Hawley-Smoot merely uses the trade collapse for political provocation.

The scale of the present disaster may be summarized in the following comparison:

During the world economy's last period of growth, between 1973 and 1979, total world trade *tripled*, from $523 billion to $1.5 trillion. Higher oil prices accounted for only $70 billion of this growth; in contrast, the exports of industrial nations rose from $387 billion to $1,074 billion. In periods of growth, world trade grows much faster than economic growth as such, because the introduction of new technologies makes the world division of labor more complex.

That was during the 1970s, when the United States still produced 140 million tons of steel per year. Now, we produce fewer than 70 million tons of steel, and world trade is *lower* in absolute terms than it was in 1981.

In 1980, all the world's nations exported a grand total of $1.9 trillion in physical goods. By 1983, the volume had fallen to $1.67 trillion, or about 12% less than the 1980 total. At the height of the supposed "recovery," in 1985, world exports were only $1.72 trillion, still 10% lower than the 1980 level. During the 1975-80 period, world trade had grown by 5% a year.

The true position of world trade is even worse than the numbers show. To start with, American imports rose from a total of $256 billion in 1980, to $361 billion in 1985. These imports, bought at 40% to 70% below American producer prices, merely replaced production capacity we lost at home. In other words, the increase in U.S. imports reflects, not economic growth, but decay. Total world trade in 1985 minus the $104 billion increase in U.S. imports was only $1.663 trillion, lower than the supposed nadir of international trade in 1983, when exports fell to $1.667 trillion.

Discounting the bloating of America's import bill, the fall in international trade since 1980 amounts to 19%--not quite as bad as the worst of the 1930s, but grim by any historical standards.

In fact, American imports grew from a steady 14% of total world imports between 1977 and 1981, to 19% of the total in 1986, corresponding to the collapse of American industrial capacity. In absolute terms, American imports more than tripled between 1977 and 1986, from $120 billion per year, to $380 billion per year.

During the same period, the United States lost:

* Half of its steel production;
* More than half of its non-ferrous metals production;
* Half of all construction expenditures for economic infrastructure;
* Nine-tenths of its expenditures for utilities construction;

* A fifth of its automobile output;
* A fifth of housing construction;
* More than half of farm-equipment production;
* More than half of machine-tool capacity.

And so forth. What this country can no longer produce, it imports from abroad.

Not only has the volume of world trade declined; as in 1930s, prices in world trade have collapsed along with volume. The International Monetary Fund's comprehensive index for commodity prices, which sets the 1980 value at 100, stood at less than 70 as of October 1986. That is, commodity prices have dropped by more than 30% since 1980, comparable to the worst of the 1929-35 period.

The 1930s and the present

There are two principal objective differences between the present and the 1930s.

First, in 1919, the United States economy exported 16.4% of its goods output, and imported the equivalent of 8.3%. That is, our export capacity--prior to the ruinous 1921-23 Depression--was in excess of 9% of our total industrial output, and this at a time when industry still maintained high rates of capital formation, associated with the First World War. That is a good, rough measure of the U.S. economy's capacity to generate surplus product.

Today, we import net goods equivalent to a fifth of general consumption, and a quarter of consumption of capital goods in particular--and this while galloping disinvestment is tearing down our industrial, electrical, and transportation infrastructure. Despite the staggering import volume, we remain sharply in deficit with respect to basic infrastructural requirements. One example: In 1977, the United States spent $230 for every citizen in infrastructural construction (including industrial and utility plants); by 1985, that had fallen to half the previous level.

Our most pressing problem during the late 1920s and, of course, the 1930s, was that the overhang of debt stemming from war reparations prescribed by the Versailles Treaty, strangled our export markets. Exports fell from 16.4% of our goods output in 1919, to only 9.6% in 1929; and without such export markets, America's industry and agriculture could not sustain the rapid buildup of new plant capacity that had begun with, and followed, the First World War. Our problem now is the precise opposite: We are dependent on the rest of the world's output, so much so, in fact, that the road to recovery reminds the analyst of the Maine farmer's quip to the lost traveling salesman: "You can't get there from here." In other words, the United States cannot produce its way out of the present hole with its existing productive capacity, and its existing skilled labor force, in the absence of imported goods, particularly capital goods.

The second objective difference between now and the 1920s and 1930s regards the existence of the Soviet Union, the principal beneficiary of the trade and currency war between Europe and the United States. Since the 1982 imbroglio over the Soviets' gas pipeline to Western Europe, when Helmut Schmidt was still German chancellor, preparations have been underway among a European financier and political faction, to "decouple" Western Europe, economically and politically, from the United States. This faction, centered in the Venice-Zurich-Munich insurance cartel, finally has its opportunity, gratis of Washington's idiotic policy.

The end of the subsidy

American imports now amount to 20% of total domestic physical consumption, and 25% of new capital goods purchases. The financing of the subsidy depended upon two factors:

1) The enormous increase in the dollar's value between 1978 and 1984, when it rose from DM 1.80 at its low point to DM 3.30 at its peak. This permitted the United States to purchase foreign goods at 40% below the comparable cost of production.

2) The evolution of a captive "dollar bloc," comparable to the colonial "sterling bloc" of the 1930s, which then permitted Great Britain to purchase raw materials with a pound valued at artificially high levels with respect to the Empire, despite the pound's falling value against other industrial nations' currencies.

Of course, the dollar's fall to the neighborhood of DM 1.90 in the past several weeks underscores the difficulty of maintaining purchases from Japan and West Germany under present conditions. The enormous increase in the U.S. trade deficit, from about $150 billion in 1985 to an annual rate of $230 billion in November 1986, reflects not so much an increase of purchases, as the higher cost of these purchases.

However, as the Dallas Federal Reserve has pointed out, the dollar has fallen only by 6.4% against the average of its trading partners' currencies, and the weighted average of the fall is less than 10%--compared to the 40% declines against the German mark and the Japanese yen. That is because the "dollar bloc," including Taiwan, South Korea, Brazil, and other important developing-sector trading partners of the United States, has kept its currencies falling with the dollar.

That has led to some remarkable financial distortions, including the accumulation by Taiwan of $25 billion of U.S. Treasury securities since January 1986. That reflects speculative purchases of the Taiwan dollar, which has lost so much value against the Japanese yen that it will soon have to leave the "dollar bloc."

In Ibero-America, exporters have had to accept prices for their manufactured goods at 70% below comparable U.S. cost of production, at the expense of 10% to 20% reductions in living standards each year, according to a study performed by *EIR* for spring 1986 [cf2]Quarterly Economic Report.[cf1] This decline was measured between 1981 and 1983, based on comparison of price and unit data for a group of 35 major commodities. Surprisingly, exports of raw materials from Ibero-America to the United States declined, while exports of manufactured products rose spectacularly. International Monetary Fund programs forced devaluations of those nations' currencies against the dollar, producing declines in the export prices of their manufactured goods even larger than the fall in the prices for their commodities listed on international exchanges.

The problem is that the dollar-bloc countries do not have sufficient economic weight to provide the United States with the size of subsidy it requires.

There is a miserable fraud involved in Yeutter's attacks on Western Europe. Yeutter's strike at selected European food exports was calculated to hit every European Community (EC) country, to score maximum political damage. The list was apparently drawn up to damage important export categories in every European country, without benefit to American producers.

These measures are irrelevant to the U.S. trade problem. The deeper problem is that the collapsing American dollar, and the $200 billion overhang of U.S. net foreign indebtedness, have shut off the means to finance the trade subsidy. The United States will begin to live on what it produces, that is, undergo the worst contraction of consumption in its history.

The dollar now stands close to DM 1.80, or barely more than half its January 1985 peak of DM 3.47; and there is no reason to believe that it will not fall to the range of DM 1.50 or lower during the next couple of months. That constitutes a "doomsday scenario" for the so-called economic recovery touted by the administration. By maintaining the growth of consumer credit at over 15% per annum, and importing the goods corresponding to the credit expansion, the U.S. economy has maintained at least the semblance of functioning, despite the utter ruin of steel, nonferrous metals, agriculture, mining, machine tools, and heavy construction, as well as the sharp deterioration of auto, electronics, and homebuilding.

The dollar crash has now eliminated both America's capacity to afford such imports, as well as its capacity to persuade foreigners to continue to finance these imports. November's trade deficit, at an annualized rate of $230 billion, triggered the situation in a sense: it represented the turning point, at which much more of the collapsing U.S. currency would have to be paid out, for a smaller physical volume of imports.

In the meantime, the dollar's uneven collapse against different European currencies has produced monetary chaos and political tensions in Western Europe, whose apparent cure seems to be to break with the dollar altogether. After 10 hours of negotiations the weekend of Jan. 10-11, the European Community finance ministers revalued the German mark by 3%, the Belgian and Luxembourg francs by 2%, and left other currencies unchanged. West Germany agreed to the revaluation, to the detriment of its export industries, and two weeks before national elections, after its central bank spent billions of dollars supporting other European currencies.

But the prospects for European currency stability following the realignment are no better, as the London Financial Times wrote Jan. 13: "The key question is whether this week's small DM revaluation will do more than buy a little time.... The European Monetary System has been under pressure since early 1985 (as it was before 1983) largely because of the dollar's weakness. When investors become disillusioned with the dollar, capital tends to flow disproportionately into the DM because other EMS units play little role as investment and reserve currencies."

As the dollar continues to fall, i.e., as dollar-holders seek refuge in the German mark and, to a much lesser extent, other European currencies, monetary chaos in Europe will be uncontrollable. Talk of exchange controls, which emerged when capital was flowing into the dollar during 1981-83, will be revived with a vengeance, to keep money out. European export industries, meanwhile, will be unable to sell to the United States, because American buyers will either be unable to afford, or not allowed, to buy their products, or both.

In the very short run, the United States, the world's largest net debtor, is in danger of a mass exodus of foreign capital, leading to a drastic rise in interest rates, and a collapse of all securities markets (not to mention real estate). That is why Federal Reserve chairman Paul Volcker, who has long warned of the potential for such a disaster, is reportedly aghast at the Treasury's handling of the current mess. However, since he helped create the series of disasters that led to this juncture, and it does him little good to repent at the extreme consequences of his own policy.

The
LaRouche Democratic
Campaign

P.O. Box 17068, Washington, D.C. 20041

Treasonous Trilaterals Organize Trade War With U.S. European Allies

Jan. 8—The respective U.S. and European branches of the Trilateral Commission, centered around attorney Lloyd Cutler, have brought the United States and its European allies to within weeks of the outbreak of war—trade war. The principal figures among the agents-provocateurs who have organized this political conflict, on both sides of the Atlantic, are members of the Trilateral Commission. Apart from Moscow itself, the principal beneficiary of such a trade war, is the Soviet empire. The financial interest which stands to gain the greatest financial profit from such a trade war, is a consortium of international food cartels, including the Minnesota-based Cargill grain monopoly interests of the United States strongly represented in the U.S. Department of Agriculture's officialdom since the early 1960s, and under Secretary Richard Lyng today.

The details of the current roles of the Trilateral Commission and Cargill interests are matters adequately documented in currently breaking news dispatches on both sides of the Atlantic. I wish to draw attention to two outstanding aspects of Cargill's background-role in this connection, and then to concentrate the remainder of my remarks on the strategic lunacy of the present eruption of trade-war itself.

For about 20 years, the policies of the Cargill-steered U.S. Department of Agriculture have been moving the United States toward two very ugly end-results. Since the first butter giveaway to Moscow, under the Nixon administration, run under the cover of a U.S. subsidy to New Zealand dairy-export monopolies, U.S., Canadian, and Western European nations have been subsidizing the Soviet arms build-up with a massive flow of food subsidies. The image of the Soviet Red Army, sliding into Afghanistan on a sea of U.S.-subsidized butter, is, symbolically, an accurate one. Meanwhile, the complex of Minnesota financial interests politically intertwined with Cargill, have been leaders, both in conduiting U.S. technology to Moscow, and conduiting Soviet peace propaganda into the United States.

At the same time, the same combination of Cargill-centered food monopolies and the U.S. Department of Agriculture, have been developing the preconditions for a political dictatorship inside the United States: a dictatorship based upon "food control."

If we estimate the food-consumption requirements of the U.S. population in terms of a standard market-basket of good nutrition, a growing food-production shortage is developing inside the United States, and a more savage food shortage already exists world-wide. Yet, we are cutting back the food production of North America, Argentina, and Western Europe, the only regions within a starving world organized to produce a surplus for large volumes of export. More and more, control of dwindling food supplies, is falling into the hands of a handful of firms, representing a Switzerland-based international foodstuffs cartel. More and more U.S. households rely less and less on the family kitchen, and more and more on "fast food" operations. The independent farmer is being wiped out of existence, as production of food is concentrated under the direct control of the international cartel and vast chains under the control of that cartel's monopoly.

Compare wartime food rationing, the food stamp program, and the methods by which food control has been used by the Soviets in Eastern Europe, with the conditions of controlled food shortages toward which the United States and Western Europe are being pushed today. We are not far from the potential circumstances under which politically-sensitive food rationing could be introduced in North America and Western Europe. Those among us who have observed the way in which the world drifts these past decades, sometimes speak of "Murphy's Law": whatever nonsense could potentially occur, usually does occur. Since there are those in the U.S. intelligence community who have been talking of a drift toward politically-shaped food control for more than a dozen years so far, the likelihood that the conditions for food control will lead to food-control programs, is to be taken seriously.

The time might come, when the words which come out of your mouth, and the way your locality votes in elections, determine whether food goes in.

Apart from the potential for future would-be dictators of the United States, the increase in food shortages is an immense source of super-profits for Cargill and other members of that wicked cartel. Since Cargill virtually runs the policies of the U.S. Department of Agriculture, and has for more than 20 years, the present drift of U.S. agriculture policy should not surprise anyone. Nor should we be surprised by the fact that foodstuffs are the leading issue of the trade war which the Trilaterals are now organizing on both sides of the Atlantic.

True, something must be done about the skyrocketing U.S. balance of trade deficit. A 200% tariff on European wines and cheeses is not going to help that trade deficit one bit. The Europeans will simply impose matching tariff walls against U.S. exports, at a time when those countries' markets for U.S. goods are being depressed rapidly in any case. Boycotting West German machine-tools isn't going to help one bit, since the United States no longer produces a significant amount of machine tools: the Nixon, Carter, and Reagan administrations have already succeeded in shutting down U.S. machine-tool production.

House Speaker Jim Wright is approximately correct, in reporting that during the past four years, the United States has been transformed from the world's largest creditor, to the world's biggest debtor—and, he might have added, the world's worst credit-risk among major nations. He should have added, that "four years ago" is the time that Treasury Secretary Donald T. Regan and Kissinger Associates, Inc. acted to shut down the import-markets of Central and South America. He should have added, that the reason the Reagan administration took such actions causing the spiralling of U.S. trade-deficits, was that President Reagan decided, during the spring of 1981, to continue the Federal Reserve policies which President Jimmy Carter and Paul Volcker had launched during October 1979.

Up to 1982, what we call the developing sector was the market on which North America, Japan, and Western Europe depended for the net margin of export-balances of the industrialized nations as a whole. Those markets began to shrink under the new international monetary rules adopted at the 1972 Azores and 1975 Rambouillet monetary conferences. The 1979 actions of the Carter administration plunged the developing sector into an insoluble and worsening debt crisis, which exploded as the 1982 "debt bomb." The Reagan administration responded to the 1982 crisis in the worst possible way, ordering debt-ridden nations to slash their imports from Europe and the United States, and forcing those nations to increase their exports into the United States.

At the same time, over the past 10 years, especially, the U.S. industrial and agricultural sectors have been gutted into a state of accelerating collapse by U.S. government policies aimed at helping us to become a "services"-oriented "post-industrial society." The idea was, that we should shut down chunk after chunk of our industry, and fill our market-baskets with low-priced imports of food and manufactures, instead.

Then, in 1983, came the "economic recovery" which never happened. True, the rate of collapse during 1983 and 1984 was much slower than during the summer and fall of 1982. During the second half of 1982, the rate of collapse touched a 12% rate, and rebounded to a rate of collapse of nearly 5% during 1983 and 1984. Then, during 1986, we collapsed the physical-goods producing sector of our economy about 15%, much worse than 1982: but the President wishfully insists that this is a "wonderful economic recovery," even after the voters massively rejected his "recovery" in the November 1986 elections.

The Reagan administration is reacting as the Hoover administration reacted to the crises of 1929 and 1931. The administration has been drifting, over the past six months, toward a repetition of the same sort of trade-war policies which set off the Great Depression of the 1930s, the infamous Smoot-Hawley tariff legislation. That is precisely what the trade war with Europe represents, a revival of the lunacy of Smoot-Hawley.

There is no solution, unless we face the cruel fact that the U.S. economy has been in a roller-coaster series of ups and downs, mostly down, over the entire period of the Reagan administration so far. Once Washington faces that fact, the solution is in sight. What we need, what Western Europe needs, and what our developing-sector markets need, is a genuine, old-fashioned sort of general economic recovery.

True the GNP figures insist that a recovery has been in progress, although every major branch of the physical economy, basic economic infrastructure, national defense procurement, agriculture, manufacturing, and energy production, has been collapsing over the past 10 years. The GNP figures are partly faked, for political reasons, as most administrations of the past 20 years have faked their GNP and inflation-trend reports. Yet, faked figures are not the whole reason the government has been describing a slide into a depression as an "economic recovery." The level of purchases of the U.S. has been kept up significantly, by using more and more borrowing to buy goods and services way above our national income. That is how we were turned from the world's major creditor, into the world's biggest debtor. Subtract the increase of combined public and private debt from the GNP figures, and the result is a figure with some resemblance to the fact of collapsing infrastructure, agriculture, and manufacturing.

Very simply, we must earn more. On this point, Speaker Jim Wright is on the correct track in his thinking. We need an investment boom in basic economic infrastructure, agriculture, and manufacturing, especially in high-technology capital goods of competitive export-quality. We must study the success of Peru's economy under President Alan Garcia, and recognize that similar reforms throughout Central and South America, for example, will reopen the precious export markets upon which we used to depend so much. Instead of squabbling with Japan and Western Europe, over shares of the world's worsening poverty, we ought to be negotiating fair shares of a world whose markets are expanding.

I find it not surprising that the Cargill and Trilaterals who are the softest on Moscow, should be leading in organizing trade wars which can help no one but Moscow.

Authorized and paid for by the LaRouche Democratic Campaign, Edward Spannaus, Treasurer

(Programmatic statement)

PROPOSED LEGISLATION FOR STATE LEGISLATIVE MEMORIALIZATIONS TO THE FEDERAL GOVERNMENT ON EMERGENCY ECONOMIC MEASURES:

WHEREAS, the collapse of the industrial and agricultural capabilities of this country pose a national security threat from the standpoint of defense, public health, and general well-being;

WHEREAS, the everyday destruction of rural and urban life, the increase of poverty, the closing of farms and manufacturing, and the collapse of our education system easily demonstrates the absurdity of those who claim that the nation is undergoing an economic recovery;

WHEREAS, since 1979 when Paul Volcker became Federal Reserve Board Chairman, the United States has lost half of its steel production, more than half of its non-ferrous metals production, half of all construction expenditures for economic infrastructure, nine tenths of its expenditures for utilities construction, a fifth of its automobile output, a fifth of housing construction, more than half of its machine tool capacity, more than half of farm equipment production, and more than 500,000 farms;

WHEREAS, last year the United States, a country that once had the greatest balance of trade surplus in the world, registered a balance of trade deficit topping $170 billion, the greatest trade deficit of any country ever;

WHEREAS, 138 banks, a post-depression record, failed in the U.S. during 1986 and almost ten percent of the FDIC-insured banks are on its troubled list;

WHEREAS, surveys of homeless show 60,000 homeless for New York, 50,000 for Los Angeles and similar depression statistics of homeless throughout urban and rural America;

WHEREAS, such depression connected diseases as tuberculosis and AIDS have become major public health hazards, threatening national catastrophe, if not solved;

WHEREAS, the hardship, social and economic dislocation, and dangers to our national security and the security of the Western Alliance are the greatest yet in the Post World War Two period;

THEREFORE, be it resolved that for the well-being of this nation the following emergency banking measures go into effect:

1. The President must declare a national economic and strategic emergency.

2.0 The President must enact emergency measures of reform of currency and banking.

2.1 Under his emergency powers, according to statute and the Constitution, he must 'nationalize' the Federal Resrve System. He must suspend the Federal Reserve System's powers to:
  a. Issue its own currency, or to exercise any discretion over policies pertaining to the issue of currency;
  b. Set interest rates at its own discretion;
  c. Set banking reserve-ratios at its own discretion;
  d. Operate a 'Keynesian multiplier' in the banking system.

2.2 Excepting Federal Reserve Notes remaining in circulation from old issues, the only lawful issue of currency shall be U.S. Treasury Currency Notes. These notes shall be issued as an Act of Congress, according to Article 1 of the U.S. Constitution.

These notes shall not be issued in payment of government operating expenditures, but shall be issued only for lending to approved categories of borrowers, through the national banking-system, on terms, and at interest-rates determined by the President according to the powers as shall be assigned to him for this purpose by Act of Congress. We recommend the interest rates be set at 2 to 4 percent.

THE LENDING OF THESE ISSUES SHALL BE RESTRICTED TO:

a) Purchase of machinery, tools, equipment for research of production of goods in industry, agriculture, and development and maintenance of basic economic infrastructure;

b) Purchase of materials, semi-finished goods, and labor for production and maintenance of goods-production of industry and agriculture, and of basic economic infrastructure:

c) Loans to the Federal government for National defense or for the purposes of governmental capital imporvements of basic economic infrastructure of Federal, State, and Local government agencies;

d) For approved export-credit, of U.S. exporters of capital goods, agricultural goods, and engineering services.

The new issue of U.S. Treasury Currency Notes, shall have a gold-reserve value, under agreements of reciprocity negotiated with other governments entering into a gold reserve system with the United States. We propose that gold be valued at approximately $750 per ounce.

2.3 The United States must institute foreign-exchange controls for the duration of the emergency. Opponents of the emergency action, will otherwise collaborate with foreign interests, to organize attempted 'runs agianst the dollar.'

2.4 Emergency action must be taken to halt the collapse of banks. We cannot permit banks to cease functioning because they have a vital public and national-security interest and are an indispensable institution of our national economy. Two interests must be protected. First, depositors must be protected at 100% parity. Second the bank's continuation of customary banking services, to those aspects of the community which are defined as having high national priority, must be assured.

3.0 The United States must disassociate itself from, and oppose so-called 'IMF conditionalities' and kindred policies and measures by supranational agencies. Support of IMF 'conditionalities' and kindred measures drives the desperate populations of affected nations into a state of insurrection against the governments that support conditionalites or it drives allies of the United States into Soviet spheres of influence. The most efficient means of nullifying IMF 'conditionalities' is to enact monetary and economic reforms of the domestic life and foreign trade of the United States and to establish Treaty-agreements with governments of other nations, establishing the kernel of a new international monetary system which is consistant with the principles of international law upon which the United States was founded.

FURTHERMORE, BE IT RESOLVED that government directed investment in economic infrastructure has always proven to be the most efficient means of rapid economic development. And the U.S. transportation grid, fresh water management, and the urban infrastructure of its cites were once the foundation of the U.S. economic miracle. The collapse of these areas now threatens the United States as an economic superpower. Therefore, the following sampling of crucial concrete policy actions that must be taken to fill the gap of a more than $3 trillion national infrastructure deficit relative to 1970 that this nation has built up defines the correct direction for economic revitilization: The aforementioned banking measures will facilitate these efforts.

1. Immediate and large flows of gold-reserve credit to Public utilities and capital programs of government for infrastructure development.
2. Long-term construction loans, at 2% prime interest rate, must be supplied to the Federal and state governments, for work on the development of a national fresh-water management grid, including the NAWAPA project, with priority on construction in areas most affected by drought and the lowering of water-tables.
3. Long-term credit, at 2% prime interest rate, must be made available to public utilities, for creating not less than 5 trillion kilowatt hours of generating capacity during a period of not less than fifteen years ahead.
4. Long-term credit for construction of a renovated freight and passenger rail system among principle population centers.
5. The U.S. Corps of Engineers must be expanded, both for its essential role in developing the fresh-water management grid, and its related role in rebuilding and extending the nation's system of inland waterways and ports. In addition to

accelerated dredging of waterways and repair of locks, immediate priorities must focus upon the Ohio and Mississippi river systems, on the completion of the Tennessee-Tombigbee system, and the completion of a barge canal linking Lake Erie to the waterways in the Pittsburg region. Furthermore the I-Conn-Erie project to modernize the Erie Canal must be initiated.

6. We need long term credit to create a U.S.-flag maritime fleet of high speed cargo vessels, most probably in the 50,000-100,000 ton class. This fleet shall be part of the military reserve.

7. To refurbish the essential ocean-vessel ports of the United States, and incorporated construction and repair facilities.

8. To provide gold-reserve credit to states and local government for urgent repairs of essential infrastructure.

9. To reinvigorate the system of veteran's hospitals by aid of making such institutions national centers of clinical care and laboratory research facilities in treatment of diseases of aging of tissues, such as cancer. To provide loans for capital improvements and expansion of plant and equipment for this purpose.

10. To provide low cost, long term credit to those industries which must expand and/or retool their production capacities, that they might fulfill their functions as vendors to both national defense and the principle infrastructure development programs making use of loans of gold reserve credit.

11. To establish several experimental stations whose activities are inclusively devoted to development of improved methods and procedures of desalination of salt water.

STATEMENT BY
NATIONAL PRINTING EQUIPMENT AND SUPPLY ASSOCIATION, INC. (NPES)
BEFORE THE
COMMITTEE ON FINANCE
UNITED STATES SENATE
FEBRUARY 5, 1987

I. INTRODUCTION

National Printing Equipment and Supply Association, Inc. (NPES)

The National Printing Equipment and Supply Association, Inc. (NPES) is a national trade association whose member companies are engaged, within the United States, in building, manufacturing, repairing, selling, importing for sale or distributing machinery, equipment and supplies used in the Graphic Arts Industry. Together with associate members (such as trade publications and firms offering related graphic arts services), NPES membership currently stands at approximately 260 companies which account for about 90% of domestic production of graphic arts equipment and supplies. Nearly 60% of NPES members are small businesses with gross sales of $5 million or less.

NPES welcomes and appreciates this opportunity to submit testimony to this distinguished Committee on a topic of great importance to our nation. Specifically, we speak of the United States international industrial competitiveness. Because this is the first time that NPES has filed testimony with the Finance Committee, a brief description of our industry seems appropriate.

The Printing Equipment and Supply Industry

America's graphic communications industry requires an enormous variety of products to do its work. The printing equipment and supply industry provides the products that meet these needs. The most obvious of these products, printing presses, represent just one stage in the long and technically complex task of transforming ideas into printed materials. Every printing job, from the simplest to the most elaborate, goes through the same basic states: pre-press, press, and bindery.

The products employed in the printing industry include typesetting systems, page composition systems, negative- and plate-making equipment, presses of all types, press accessories, and binding and finishing apparatus. Printing industry supplies include papers, films, plates and chemicals for phototypesetting and other pre-press functions.

Printing Trades Machinery (SIC 3555) is identifiable as a discrete category within the more general classification of Special Industry Machinery of the Department of Commerce Standard Industrial Classifications System (SIC). The graphic arts supplies portion of the industry is less readily identified, as these products typically are not aggregated as a separate group, but are spread across several broader industry categories, such as chemicals and photographic supplies.

The total market for printing equipment in 1985 approached $2.1 billion in orders and $2.5 billion in product shipments. Shipments of printing industry supplies totaled approximately $1.7 billion in 1985.

America's Graphic Communications Industry

The relatively modest size of the printing equipment and supply industry belies its critical role in supporting the much larger, crucially important graphic communications industry.

According to the 1982 Census of Manufacturers, of the 20 major manufacturing groups included in the SIC, printing and publishing ranks first in the number of establishments. There are more than 90,000 printing establishments nationwide, including 53,000 separate printing firms and an estimated 40,000 additional businesses that have their own in-plant printing operations. Printing and publishing alone employ some 1.4 million people, representing a total payroll of close to $30 billion annually. Total sales for 1986 are expected to exceed $118 billion.

Achieving Consensus

Because of the diverse nature of the membership of our Association, encompassing manufacturers and distributors of both foreign and domestically produced graphic arts machinery and supplies, we are currently engaged in a process of achieving a consensus policy position on United States international industrial competitiveness, not dissimilar from the Finance Committee's task of achieving an equitable policy balance in this area. As our more comprehensive position statement is finalized, we will happily share it with the Finance Committee. Meanwhile, at this time we would like to submit for your recent committee hearing record of January 1987 the following comments on several specific topics which we believe to be especially relevant to United States international industrial competitiveness.

II. U.S. INTERNATIONAL INDUSTRIAL COMPETITIVENESS

America's competitive preeminence in world commerce has eroded over the past decade. We are being challenged in the trading arena by the European community and the industrializing nations of the Pacific Rim and Latin America. We believe this to be a serious cause for concern, because sustaining America's competitiveness is key to maintaining our standard of living, and our national security.

Deteriorization of U.S. Manufacturers Trade Performance

It is no secret, but it bears repeating that the United States has suffered a serious erosion of industrial competitiveness vis-a-vis other leading industrial nations during the 1980's, reflected in a cumulative trade deficit for the 1980-1986 period of $630 billion and a 1986 trade deficit of $170 billion.

According to the recently published Commerce Department Report, United States Trade: Performance in 1985 and Outlook, (U.S. Department of Commerce, International Trade Administration, October 1986) the deterioration in U.S. merchandise trade performance --- trade in goods --- is the dominant factor in the growing current account deficits of recent years. And within merchandise trade, manufacturers trade is shown to be the key factor in growth of U.S. deficits. The report concludes from this that improved manufacturers trade performance is crucial to restoring U.S. trade and current account balances to sustainable levels. We fully agree with this assessment. Indeed, there is no other potential source of major gains, because continuing very large manufacturers trade deficits cannot be offset by surpluses in other goods and services trade accounts. This is self evident in light of the fact that manufactured goods represent the heart of U.S. trade, currently accounting for 68 percent of U.S. exports and 75 percent of U.S. imports, with the U.S. trade deficit in manufacturers equal to 84 percent of the total trade deficit.

Therefore the National Printing Equipment and Supply Association, Inc. believes that the U.S. Government and U.S. business should make the achievement of a trade balance an economic and strategic goal of the United States. Increased U.S. international industrial competitiveness is the heart of these goals.

As earlier noted, the topic of U.S. international industrial competitiveness is currently under review by our Association's policy-making Committees and a comprehensive statement on the subject is anticipated shortly. However, for the record of the Finance Committee's Trade Hearings of January 1987, we wish to submit the following recommendations which are already standing NPES Government Affairs policy positions, as they relate to strengthening U.S. international industrial competitiveness.

Increase the Supply and Decrease the Cost of Productive Capital to American Manufacturers and their Customers

A key element in maintaining American manufacturers' international competitiveness is keeping industrial productivity high. And a linchpin in sustaining high industrial productivity is encouraging and supporting capital investment by U.S. business. Unfortunately, in our estimation, recent government policies seem to undercut this objective. Specifically, we were greatly disappointed by the significant curtailment of capital investment tax incentives which occurred during the enactment of the Tax Reform Act of 1986 (TRA '86).

During the 99th Congress NPES was a member of the Invest to Compete Alliance (ITCA). ITCA, a group of individuals, trade associations and large and small manufacturers, banded together to impress on Congress the importance of sustaining capital investment in America's industrial base which is the underpinning of our national economic strength and vigor. Specifically, we supported retention of the Investment Tax Credit (ITC) and the continuation of the ability of U.S. manufacturers to quickly recover the cost of productivity-improving investment in industrial machinery by the rapid depreciation of that investment under the Accelerated Capital Cost Recovery System (ACRS), which was a key element of the economic recovery that followed the enactment of the Reagan Administration's Economic Recovery Tax Act of 1981 (ERTA).

Apparently, the over generousness of some aspects of ACRS, and the unfortunate abuses by some taxpayers of some aspects of the system jaundiced the view of many members of the Administration and Congress toward what we regard as a proven successful method of encouraging and sustaining investment in the U.S. industrial base.

Accelerated Capital Cost Recovery has a proven record of success. For nearly 25 years the ITC has been an effective policy tool. During times of repeal, investment declined, necessitating later reinstatement. While we do not necessarily disagree with the philosophy of cutting effective tax rates embodied in TRA '86, we, nevertheless, feel that policies such as the ITC and Accelerated Capital Cost Recovery are much more targeted and purposeful methods of bring about the desired objective of a modern and competitive U.S. industrial manufacturing base.

Therefore, we urge the Committee to consider reviewing this year what we regard as the weak capital cost recovery provisions of TRA '86, before another year goes by with inadequate investment in America's industrial base.

Minimize the Competitive Burden of Litigation and Liability Costs on American Industry by Enacting Fair and Balanced Federal Uniform Product Liability Reform Legislation

Although not usually thought of in the context of international industrial competitiveness, the current crisis in runaway insurance, litigation and liability costs on American industry is a very definite competitive handicap for U.S. manufacturers. And while the burden of the general tort liability crisis has been felt in nearly every segment of society during the past several years, the impact of the unfair and unpredictable product liability system has been shouldered by U.S. manufacturers for over a decade.

In this regard, NPES supports fair and balanced federal uniform product liability reform legislation. Specifically, we strongly supported legislation introduced during the 99th Congress, S. 2760, which enjoyed wide bipartisan support in the Senate, but was blocked in the final days of the 99th Congress by a small group of Senators who are apparently more concerned about maintaining the lifestyle of some members of the trial bar than ensuring that injured people received quick adequate recovery for injuries, that U.S. consumers do not have to pay the price of an inequitable and inefficient U.S. civil justice system, and that U.S. manufacturers can afford to stay competitive with their foreign counterpart.

With regard to the last point, the Committee Report on S. 2760 (Report 99-422) sheds some very useful light on this subject wherein it states:

> The adverse effects of the product liability system have carried over into international trade. American manufacturers and product sellers generally pay product liability insurance rates which are 20 times higher than those in Europe. This disparity is attributable in large part to the uncertainties and costs of the American tort litigation system. As a result of this disparity, American manufacturers and product sellers may be at a competitive disadvantage in both foreign and domestic markets. Insurers generally do not discount premiums where a manufacturer exports it goods, because there is always the possibility that a product-related suit will be brought in the United States. Thus, each U.S. product shipped abroad contains an insurance cost element greater than that of a foreign competitor. With respect to domestic markets, the effect of the current uncertainties in product liability law is similar. The price of imported products can be lower because product liability insurance rates for those products are lower.

III. SUMMARY

In summary, we believe that failure to take these modest actions will likely increase pressures for damaging protectionist measures such as increased tariffs, quotas, and other nontariff barriers.

We further believe that the U.S. Government should make the achievement of these goals one of its highest priorities; and that enhancing U.S. competitiveness should be a touchstone for future legislation and other major policy initiatives.

Accordingly, NPES urges the Committee, the Congress and the Administration to take into account the effect on U.S. competitiveness in the drafting of legislation and the development and implementation of national policies.

Once again, we thank the Committee for this opportunity to testify and would be happy to respond to any questions.

WRITTEN STATEMENT OF RECORDINGS IMPORT TRADE COMMITTEE

COMMITTEE ON FINANCE
UNITED STATES SENATE

SUBMITTED FOR FURTHER HEARINGS ON
"MASTERING THE WORLD ECONOMY"

FEBRUARY 26, 1987

Taft, Stettinius & Hollister
1620 Eye Street, N.W.
Washington, D.C. 20006

Robert Taft, Jr., Counsel

STATEMENT OF RECORDINGS IMPORT TRADE COMMITTEE

The Recordings Import Trade Committee (RITC)(with membership consisting of JEM Records, Tower Records, Dutch East Trading, and Import-O-Disc) strongly supports the passage of legislation to implement the Nairobi Protocol to the Florence Agreement on the Importation of Educational, Scientific, and Cultural Materials. In the 99th Congress, RITC filed statements to that effect with the House Trade Subcommittee on August 30, 1985, and the Subcommittee on International Trade of the Senate Finance Committee on April 21, 1986. H.R. 3 in this session includes the same language (Sections 871-875). This statement is submitted in support of provisions identical to these sections of H.R. 3, as a part of S. 490 and/or as a part of any omnibus trade or miscellaneous tariff bill. We request that it be filed as a part of the record of these hearings.

The purpose of the Florence Agreement, which entered into force for the United States on November 2, 1966, is to facilitate the international flow of cultural materials (including books, publications, documents, works of art, collector's pieces, visual and auditory materials, scientific instruments and apparatus, and articles for the blind) through the extension of duty-free treatment. The purpose of the Nairobi Protocol is to broaden the list of products eligible for such treatment, including articles for the use of the blind and other handicapped persons. Since the proposed treatment is believed to be noncontroversial within the United States and its trading partners, it is believed to be very appropriate for inclusion in any major trade bill. The proposal is obviously one of trade policy, designed to increase trade in both directions. It is not just a miscellaneous tariff item.

The President, on January 16, 1981, submitted the Nairobi Protocol to the Senate for its advice and consent. On January 12, 1983, the Educational, Scientific and Cultural Materials Importation Act of 1982 ("the 1982 Act") (Publ. L. 97-446; 96 Stat. 2346) was enacted directing (in section 167(b)(1)) the President to proclaim temporary duty-free treatment for certain imported articles which would be covered by the Nairobi Protocol and authorizing the proclamation of duty-free treatment for other such items, if the President found it to be in the interest of the United States. The President found it to be in the interest of the United States and issued a Proclamation (#5021 of February 14, 1983) which instituted said duty-free treatment until August 11, 1985. Since that date liquidations have been suspended in view of the pendency of legislation which was expected to and would have had retroactive application. Due to a change in U.S. Customs Service policy since January 1, 1987, while this suspension of liquidation continues, the duties have been posted as required by new U.S. Customs Service policy.

These sections of H.R. 3 were introduced in this Congress to authorize the President to deposit an instrument of ratification for the Nairobi Protocol, including Annex C-2, and, if he finds it in the interest of the United States, to extend duty-free treatment to Annex C-1 items, subject to certain conditions.

This H.R. 3 language would provide for the ratification of the Nairobi Protocol, which the United States signed in 1979, and for which the advice and consent of the Senate was received in October 1982. The Department of Commerce stated last year to the Committee "it is the view of the Administration that ratification of the Protocol is in the national interest" (page 1, fourth paragraph). This was reaffirmed by Mr. Louis J. Murphy, Acting Director, Office of Industry Assessment of the Department of Commerce on February 10, 1986, before the House Trade Subcommittee. This is still the Administration's position.

The overwhelming weight of the comments received last year was that the legislation should be passed to enable ratification to take place. One industry which raised concern, hearing aids, is availing itself of administrative remedies and did not oppose ratification. We note the statement of the Scientific Apparatus Makers Association before this Subcommittee on April 8, 1986, regarding export of scientific instruments under the Florence Agreement. The question raised there related to current operation of the Florence Agreement rather than to the Nairobi Protocol. We have no position on the issue except to note that Title III, Sec. 301(a)(1) and (2) of S. 1274 (legislation from the last Congress) would appear to have provided an administrative remedy for the problem.

As noted in the submissions last year by the Association of Research Libraries, the American Library Association, and the Department of Commerce, the legislation provides both a mechanism and ample opportunity to redress for any industry adversely affected by the passage of this legislation and any resulting implementation of duty-free treatment.

It should be noted that further delays in action on the Nairobi Protocol would be unfortunate. It is suggested that the language should be included in the first trade bill to pass this Congress. Entries of articles which could be covered by the legislation, if enacted, have had their liquidation temporarily suspended. Without knowledge of what duty rate will apply, pricing in these markets is uncertain, at best, and therefore discouraging trade in both exports and imports.

The purpose of both the Florence Agreement and the Nairobi Protocol is to aid the unfettered dissemination of the materials covered. Quick passage of this legislation would demonstrate our national commitment and send a message to other signatories of the Protocol, particularly the European Communities ("EC") member states, that implementation should take place quickly.

Timing is important because the EC has definite procedural rules under which the next opportunity for tariff reductions in the EC is July 1, 1987, and the next thereafter, January 1, 1988; a six-week lead time period is necessary before the effective date to accomplish administrative matters by the EC. EC member states would be expected to institute their tariff changes by July 1, 1987, if H.R. 3 becomes law by May 8, 1987. Thus, passage of this measure would not only bring more timely benefits to our handicapped and other consumers, but also would signal the EC to act so that there would be reciprocal duty suspensions in place in the countries which form the majority of the market for the industries which support this measure as reciprocal.

Respectfully submitted,

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Import Trade Committee

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Statement for Inclusion in the Printed Record

HEARINGS ON TRADE POLICY

Will the Goals of American Trade Policy Include Justice for American Investors?

In the past, many Americans and Europeans lent large sums of money to build the railroads of Russia and China, and to develop in other ways the economies of various countries. But arrangements to deal with foreign government defaults on their loans have been lacking, and at times effort to cure defaults have been bungled.

Now is high time for goals of American trade policy to include settlement of other governmental debts to American holders of foreign dollar bonds. United States should encourage foreign governments to settle promptly their defaulted dollar bonds, and should penalize those that don't.

One should keep in mind what some other countries have done with respect to their dollar bonds. After World War II Japan decided to rehabilitate its credit. Consequently, due dates were extended somewhat, and all current interest and back interest was paid. West Germany and Austria, also, made arrangements to settle their dollar bonds, but flaws developed in their application. In late January and February of 1987 Czechoslovakia has bought in many of its outstanding dollar bonds, by agreeing to pay 98% of their face value, but wiping out all back interest. However, the offer for many bonds is only 20% of face value, and other bonds are to receive nothing. Surprised bondholders who feel that they have been badly cheated will undoubtedly seek to reopen the settlement, especially since their elected negotiator was kept out of the negotiations.

(more)

A SUCCESSOR GOVERNMENT IS RESPONSIBLE FOR THE LEGITIMATE DEBTS OF ITS PREDECESSOR.

Unbelievably, the interests of American holders of Chinese bonds are now in the hands of the president of the Foreign Bondholders Protective Council, who is in charge of a subsidiary of the Hongkong Shanghai Bank! Congress must face up to its conflict-of-interest problems involving foreign bond settlements.

Because of slipshod arrangements in the past, which have alienated informed bondholders, improved negotiating arrangements are called for, with inclusion of true representatives of bondholders.Unfortunately, foreign dollar bondholders usually have no organizations, with no funds to speak of, and no lobbyists in Washington. Our foreign trade policy must make more wholesome provisions for repayment of capital loans, and for proper payment of interest. Specifically, the Senate Committee on Finance must put high on its agenda the settling of repudiated bonds of the Peoples Republic of China, bonds of the USSR in U. S. dollars, bonds of Estonia (still a nation under tight soviet control), as well as dollar bonds of Cuba, the German Democratic Republic (East Germany), Mexico, and Czechoslovakia.

As chairman of the Russian Dollar Bondholders Committee of the U.S.A., I commend to you and ask that it be printed as part of our statement, the enclosed letter-to-the-editor which was printed in the Harvard Business Review of September-October, 1986, written by Edward M. Sills.

Respectfully submitted,
Hubert Park Beck
Hubert Park Beck, Ph.D.
(Professor Emeritus
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Chairman

U.S.-U.S.S.R. trade

In "Remarks on U.S.-U.S.S.R. Trade" (May-June 1986), Mikhail S. Gorbachev says he'd like the "fullest… use of…opportunities inherent in international cooperation, including that with the United States" in the "great plans" the Soviet Union has "for…economic, scientific, and technological development." He cites denial of most-favored-nation treatment as a primary obstacle, wants removal of export controls, and asserts that "there can be no serious trade without credits." He states he won't "beg the United States for anything." He doesn't have to. It is our own American businesspeople who are pressing his aims.

After a five-year hiatus, U.S. banks have begun accommodating the Soviets anew with loans for grain purchases in violation of the spirit, if not the letter, of the Johnson Act, which bans private investors from lending money to foreign states in default on debt to the U.S. government. Russia is in such default.

When it abolished private ownership, the Soviet Union appropriated all the property and assets its predecessor governments possessed, but it has stubbornly refused to honor their obligations. It has not paid its prerevolutionary bills.

Bonds worth $75 million with full faith and credit assurances were sold and issued by the imperial Russian government to investors in the United States through J.P. Morgan, National City Bank, and other banking institutions. This is private debt, separate from debt to the U.S. government, which itself made substantial loans to the Kerensky provisional government.

This debt, however odious to the U.S.S.R. and however aged, remains its unequivocal responsibility under international law. The debt should be cleared by payment, and new credit and trade preferences for the U.S.S.R. should not receive any consideration at all until it is.

The basis for this responsibility appears in a passage by John Bassett Moore in Volume I of the *Digest of International Law*: "Changes in the government or the internal polity of a state do not as a rule affect its position in international law. A monarchy may be transformed into a republic, or a republic into a monarchy; absolute principles may be substituted for constitutional, or the reverse; but, though the government changes, the nation remains, with rights and obligations unimpaired."

The Soviet Union acknowledged, when recognized by the United States in November 1933, that agreements then exchanged between President Franklin D. Roosevelt and Maxim Litvinov, people's commissar for foreign affairs, were "preparatory to a final settlement of the claims and counterclaims between the Government of the Union of Soviet Socialist Republics and the United States of America and the claims of their nationals." No such settlement has been made. Good faith requires one.

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Since a long roster of governments, including those of Communist nations, have honored the debts of their predecessors, their recognition by the U.S.S.R. has solid precedent. Poland, Rumania, Bulgaria, Yugoslavia, and Hungary, for instance, have all made debt settlements.

Respect for reliability of contract is essential to any concourse in commerce and is a widely accepted tenet of world trade and relations. The U.S. Court of Appeals for the Second Circuit recently enunciated this principle after Costa Rica had been brought to court for repudiating or altering external debt: "In addition to other international activities, United States banks lend billions of dollars to foreign debtors each year. The United States has an interest in ensuring that creditors entitled to payment in the United States in United States dollars under contracts subject to the jurisdiction of United States courts may assume that, except under the most extraordinary circumstances, their rights will be determined in accordance with recognized principles of contract law."

Obviously, many other issues of worldwide concern, nuclear disarmament not least among them, represent transcending priorities to be resolved for warmer relations with Russia.

In trade, however, which may well be a first tentative step to a friendly state of affairs and decidedly a worthwhile goal, the U.S.S.R. should be made to realize that it can't sweep its debts under a rug and then expect preferences. It should be required to satisfy its solemn obligations on government financial instruments sold to our private citizens as well as its debt to our government before it is qualified to receive them.

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Statement submitted by David J. Steinberg, President, U.S. Council for an Open World Economy, to the Senate Committee on Finance in hearings on trade policy, "Mastering the World Economy". February 1987

(The U.S. Council for an Open World Economy is a private, non-profit, public-interest organization engaged in research and public education on the merits and problems of developing an open international economic system in the overall national interest. The Council does not act on behalf of any "special interest".)

As I have been contending for many years in presentations to Congressional committees and other forums, a coherent trade strategy urgently, incisively and constructively addressing the nation's real problems and needs in this critical policy area should be raised to a national priority no lower than that assigned to national security. In fact, these two policy areas are closely interdependent.

The job that needs to be done to correct the serious weaknesses and vulnerabilities that have arisen in the U.S. foreign-trade position, and beyond that the country's overall international economic position, will not and cannot be done without consistent and persistent progress toward (a) a much more open and equitable world trading system, (b) commensurate adjustment of our domestic economy to the challenges and opportunities of such an international economic environment, (c) effective coordination of monetary, fiscal, education and all other policies bearing materially on this issue into a coherent, credible strategy, convincing to the American people and the world at large. The trade-policy component of this strategy should be a definitive, deliberate, expressly free-trade policy. This we have never had and are not now planning. Outside of our Council, there appears to be no one in the legions of self-styled "free traders" who, at least in public forums if at all, advocates such an initiative.

The legislative measures recently introduced by members of Congress, as well as proposals expected from the Administration, do not constitute a coherent strategy clearly delineating the highest goals to which our sights need to be raised, and the steps that must be taken to achieve these goals. Several proposals are constructive and deserving of support, but there is too much, misconceived "quick fix" in the expectations for too many of the others -- short-term illusions that appear to satisfy the aggressive inclinations of many legislators but poorly serve both long-run objectives and short-term needs. Even the proposed delegation of trade negotiating authority to the President does not redeem the proposed policy package. The supposed objectives of the negotiation seem as ill-defined and uninspiring as the assortment of buzzwords -- fair trade, competitiveness, reciprocity, etc. -- that swarm around the trade-policy dialogue these days.

Freer and fairer trade at the pace to which we have become accustomed, even in the last 10 or 20 years, is not good enough. Even the additional objectives projected for the next round of trade negotiations (services, agricultural reform, etc.) do not elevate U.S. trade policy, and the pace of freer and fairer trade per se, to where they ought to be. What is now being programmed for the next round of trade negotiations (the round of the 1980's, which will probably be the last round until late in the 1990's if not the last concluded in this century) will not be enough to reduce barriers, remedy unfairness, achieve reciprocity, increase productivity and enhance competitiveness to the degree required by the nation's economic and overall policy needs in the closing years of the 20th century. Too much backing and filling has distorted the course of commitments to freer trade throughout the world trading system. Progress toward freer and fairer trade, under today's policy and the one that seems in the offing, is likely to remain as erratic as it has always been. Even with the inclusion of sectors heretofore untouched by the many rounds of trade negotiations, many exceptions to more-open trade will linger. Our trade-policy goals need to be redefined with greater precision, and determination to reach them needs to be more resolute than the United States and its trading partners have thus far demonstrated.

Free-Trade Initiative

The initiative whose time has come should aim at programming the removal of all trade barriers and all trade inequities by the United States in concert with as many of the highly developed countries as are willing to join us in such a compact -- a "free trade area" in accordance with established international rules. The reciprocity which only a free-trade arrangement makes possible would be the ultimate, the greatest possible reciprocity -- envisioning, not only overall, "macro" reciprocity signifying each country's overall balance of give-and-take vis-a-vis each of the other contracting parties (as in past rounds of trade negotiations, none of which projected totally free trade), but "micro" or sector reciprocity as well (the programmed removal of all barriers without exception). Sector reciprocity is today more meaningful or important for some industries than others, but programming reciprocal removal of all barriers by the contracting parties (permitting the greatest possible leverage for trade-offs) is the framework essential to securing free-and-fair trade for the sectors for which a "level playing field" is vital. Today's pace of world economic development and competition warrants this new dimension in trade reciprocity. Inclusion of all products and practices without exception (though the timetables for some would undoubtedly be different from what is practical for others) could be expected to ease inevitable political resistance in all the participating countries to the phasing-out of trade restrictions in certain products and practices, inasmuch as each country would be able to cite long-nurtured, politically significant barriers the other contracting countries were required to phase-out under the free-trade arrangement.

Just as only the negotiated programming of totally free trade between participating countries can achieve the optimum (the ultimate) reciprocity that ought to be our goal, so it is also the only way to achieve the totally fair trade (or the closest possible approximation) for which we should be striving. The reason is that nothing so sweeping and electrifying as the prospect of totally free trade is capable of stimulating the domestic and foreign-economic reforms (including international monetary modifications) which totally fair trade would demand. Conversely, the programming of totally fair trade (no practices or policies exempted) is indispensable, economically and politically, to the programming of totally free trade. In short, totally free trade and totally fair trade are one and inseparable -- one strategy indivisible. And only a strategy of such scope -- only a premise of such magnitude factored into the whole fabric of decision making both of government and the private sector -- is capable of spurring the all-out resolve and resourcefulness that must be invested in the competitiveness to which the nation's best efforts must be committed.

Only the premise of a convincing national commitment to free trade will evoke the all-out commitment to export expansion that is essential to the national interest. Such a commitment may also be indispensable to the viability of many U.S. corporations under conditions of steadfast national implementation of a free-trade agreement. Moreover, such a compact, and a domestic adjustment strategy that effectively backstops it, are more capable of defusing protectionism than are the less ambitious stratagems of today's conventional wisdom.

After carefully developing a strategy to maximize public and political support at home, the President should launch the free-trade initiative by inviting the economically advanced countries to join us in negotiating a "free trade area" under the rules of the General Agreement on Tariffs and Trade. It would program totally free and totally fair trade, allowing no product or other exemptions of any kind, in accordance with a realistic timetable. Less-developed countries willing to make broad, "liberal trade" commitments within their greatly limited capacity (pending their ability to make more-detailed, more-ambitious commitments at a later time) should be entitled to the market access the participating advanced countries agree to provide one another, without being required to provide equivalent access to their markets until some distant "millennium".

The compact should be negotiated even if only one country accepts the U.S. invitation. If the U.S. initiative is credible, all the advanced countries, sooner or later, will participate -- a lot sooner than most skeptics might expect, for the price of staying out would be too high. The prospect of dependable progress toward free-and-fair trade, dispelling various uncertainties (and what are sometimes called "shocks") that often induce mercantilistic measures by countries feeling the need to protect themselves against disruptive developments inimical to their interests, would be one of the incentives to negotiate a free-trade arrangement.

The adjustment strategies needed in domestic policy to backstop such a trade-policy initiative must be more far-reaching than the now jaded term "adjustment" conveys. A credible commitment to national "redevelopment" and "full employment" should set the tone and the pace of the national, indeed nationwide, effort needed to ensure that the definitive, deliberate, free-trade initiative advances the best interests, not only of the nation as a whole, but of every state in the Union. The President should form an inter-agency "council on national economic development" (with appropriate funding by Congress and appropriate accountability to Congress) as the clearly identifiable focal point of such a domestic economic commitment. Ways should be found to bring the governors of all the states and the chief executives of all local governments into the process of formulating and fulfilling this domestic economic strategy. Close consultation with industry, agriculture, labor and other private sectors would also be essential.

Government assistance to industries that merit such aid should take the form of coherent strategies addressing the real problems and needs of these industries and the people who depend on them for livelihood. Import restriction, if justifiable at all, should be only one component of a comprehensive package of government, industry and labor commitments. The adjustment strategy should include reassessment of all statutes and regulations materially affecting the industry's adjustment capability, to determine if there are any inexcusable inequities that need correcting.

Quest for the Best

The recruitment slogan of the United States Army seems appropriate for the trade strategy whose time has come: BE ALL THAT YOU CAN BE. This means striving, not just for "competitiveness", but the greatest possible competitiveness. Not just "fair trade", but the fairest trade. Not just "reciprocity", but the ultimate in reciprocity -- ratcheting barriers downward toward programmed removal, not upward in a cycle of reciprocal moves and countermoves. Not just "free trade" as some "holy grail" always beyond reach in the real world, but a realistic goal that is worth the best shot of countries (like ours) wealthy in capital resources and human resourcefulness. A carefully crafted free-trade strategy is essential to honing those flavory but fuzzy buzzwords into the worthy objectives they ought to be.

Factoring a free-trade premise into the entire range of decisions that shape the nation's international economic performance would impel, indeed compel, the best our economic system can do -- the best we can be. International respect for U.S. policy, worldwide confidence in the U.S. economy, and a healthy, stable exchange rate for the U.S. dollar would be among the many rewards. The far-reaching steps the other participating countries would have to take in "redevelopment" and other adjustments would translate into more-rapid growth and higher standards of living in those countries -- in turn into greater demand for the kinds of goods in which the United States excels. All factors taken into account, it may confidently be anticipated that the U.S. trade balance and our overall balance of international payments would be restored to the condition vital to this country's economic viability and leadership capability.

The policy perspective I am proposing cannot rightly be dismissed as a long-term proposition long in idealistic theory but short of ways to address today's troubling problems. Harmful imbalances in the nation's international accounts certainly demand remedial action, but short-term and long-term policies need not and should not be mutually exclusive. The fact is that the admittedly long-range strategy I have outlined would yield substantial short-term dividends as steps are quickly taken to adjust to and capitalize on this dramatic initiative. Although the massive budget and trade deficits, and the nation's disturbing shift from international creditor to debtor status,are more reflective of failings in domestic policy than in trade policy, a properly designed free-trade initiative would stir extraordinary efforts to solve the domestic problems as quickly and responsibly as possible. The mobilization toward this end would be unequaled since World War II.

If we lack the capacity and the will to ensure both the short-term and long-term success of such a strategy in both foreign-economic and domestic-economic terms, then America, the Western Alliance and the world economy are in deeper trouble than we have thus far cared to acknowledge.

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